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Buyers of Used Goods and the Problem of Hidden Security Interests: A New Proposal to Modify Section 9-307 of the Uniform Commercial Code†

By LINDA J. PELTIER*

Although article 9 of the Uniform Commercial Code (article 9)¹ protects buyers of goods² in the ordinary course of business³ from the claims of secured parties, that protection applies only in situations in which the security interest was created by the buyer's seller of the goods.⁴ Article 9 contains no provision allowing one who buys used goods from a merchant to take those goods free of a previously created security interest.⁵ The result of this apparent oversight in the drafting of the Uniform Commercial Code (Code) is that good faith purchasers remain subject to the claims of remote secured parties, even though they

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1. Although this Article focuses on article 9, entitled "Secured Transactions," it should be noted that other laws—such as the federal Bankruptcy Code, state consumer protection laws, and certain federal statutes pertaining to security interests in transportation carriers—also have application to secured transactions in particular contexts. Except as such non-Code law directly affects the problem under discussion, it will not be considered in this Article.

2. Under article 9, tangible collateral, or "goods," in the hands of the debtor may be classified as "consumer goods," "equipment," "farm products," or "inventory." U.C.C. § 9-109 (1978). "Inventory" is defined as those goods "held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process or materials used or consumed in a business." *Id.* § 9-109(4). Once inventory has been sold by a merchant to a consumer, it will be classified as "consumer goods" in the latter's hands. *Id.* § 9-109 comment 2.

3. See *infra* notes 29-31 & accompanying text.

4. See *infra* notes 26-27 & accompanying text.

5. See *infra* notes 19-27 & accompanying text. For purposes of this Article, a "previously created" security interest is one created by someone who owned the goods prior to the buyer's seller.

have no knowledge of those claims at the time of purchase and even though they have no means of apprising themselves of the existence of the earlier created encumbrance.⁶

This lamentable state of affairs has been often criticized,⁷ and various proposals have been put forward to rectify it.⁸ To date, these proposals have met with little success. Ill-fated consumers who find themselves possessed of collateral subject to the legitimate claims of a secured party with a previously created security interest have had to rely upon judicial efforts to afford them some measure of relief. Although the courts have acknowledged this dilemma, their occasional attempts to insulate innocent buyers from the claims of secured parties⁹ have been, for the most part, ill-suited to the establishment of a coherent theory of commercial

6. The following stylized account presents in more general terms the problem to be discussed:

Buyer-1 purchases goods from seller-1 (a merchant) under a conditional sales contract. The resulting security interest is perfected by filing. Without the consent of the secured party, buyer-1 sells the collateral to seller-2 (also a merchant) who then resells the goods to buyer-2, a buyer in ordinary course. Buyer-1 defaults on his obligation under the conditional sales contract and seller-1 (or his assignee) seeks to enforce his security interest by either a replevin or conversion action against buyer-2.

Dugan, *Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code*, 46 U. COLO. L. REV. 333, 345 (1975); see also Skilton, *Buyer in Ordinary Course of Business Under Article 9 of the Uniform Commercial Code (And Related Matters)*, 1974 WIS. L. REV. 1, 7-8, 56. Since the security interest was perfected, it remains effective despite later disposition of the collateral by the debtor, unless the disposition was authorized or unless an exception to this principle is provided in article 9. See *infra* notes 19-27 & accompanying text. When the original security interest is *unperfected*, it is cut off by the debtor's transfer of the collateral to seller-2, assuming seller-2 has given value and taken delivery without knowledge of the security interest. U.C.C. § 9-301(1)(c) (1978). Presumably, a buyer in the ordinary course of business from seller-2 will also take free of that security interest under the "shelter" principle. See *infra* text accompanying note 134. Hence, the problem addressed in this Article is limited to situations in which seller-1, the original secured party, has perfected his security interest before his debtor disposes of the collateral.

It may be noted that the buyer's exposure to previously created security interests is not necessarily limited to purchases of used goods. The buyer potentially faces the same legal problems if she buys new goods from a merchant and that merchant purchased the goods from a retailer who granted a security interest in the goods. Since the security interest was not created by the buyer's seller, the express protection provided to the buyer of goods does not apply. See *infra* note 32 & accompanying text. However, it is likely that in this type of situation the secured party has authorized the disposition of the collateral and that other Code provisions will operate to terminate the security interest. See *infra* notes 71-84 & accompanying text. Therefore, the focus of this Article is on buyers of used goods.

7. See, e.g., Dugan, *supra* note 6, at 346-47; Knapp, *Protecting the Buyer of Previously Encumbered Goods: Another Plea for Revision of UCC Section 9-307(1)*, 15 ARIZ. L. REV. 861 (1973); Vernon, *Priorities, The Uniform Commercial Code and Consumer Financing*, 4 B.C. INDUS. & COM. L. REV. 531 (1963).

8. See *infra* text accompanying note 144.

9. See *infra* notes 79-84 & accompanying text.

law.¹⁰

This Article reexamines the problem that article 9 creates for the buyer of used goods and evaluates the proposed solutions in light of the conflicting interests that must be considered and reconciled. A solution is offered that accommodates the interests of both buyers of used goods and remote creditors.

The Statutory Scheme of Article 9

The Code was drafted with the avowed purpose of clarifying and modernizing the law governing commercial transactions.¹¹ In the area of security interests, the process of modernization resulted in the supplanting of numerous, cumbersome security devices with one "security interest."¹² Article 9 prescribes the method by which that security interest is created.¹³ Moreover, the legal consequences of the grant of a security interest are specified in detail in article 9. As a general rule, the effect of a security interest is as provided in section 9-201: "Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors" Thus, unless an exception is specifically provided elsewhere in the Code,¹⁴ the effectiveness of the security agreement is presumed, and the agreement will be enforced, even against third parties.

Conflicting claims to a debtor's property¹⁵ will be resolved by refer-

10. See *infra* notes 90-100 & accompanying text.

11. The purposes of the Code are articulated in § 1-102(2):

Underlying purposes and policies of this Act are

(a) to simplify, clarify and modernize the law governing commercial transactions;

(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;

(c) to make uniform the law among the various jurisdictions.

12. For a thorough description of the various pre-Code security devices, such as the pledge, chattel mortgage, conditional sale, and trust receipt, see 1 G. GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* (1965); see also J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* § 22-1, at 873-74 (2d ed. 1980). The unitary security device adopted in the Code—the article 9 security interest—is defined as "[any] interest in personal property or fixtures which secures payment or performance of an obligation." U.C.C. § 1-201(37) (1978).

13. A security interest is created, or "attaches," upon the occurrence of three events: (1) The secured party has possession of the collateral pursuant to agreement, or the debtor has signed a valid security agreement; (2) value has been given; and (3) the debtor has acquired "rights in the collateral." U.C.C. § 9-203(1) (1978). See generally J. WHITE & R. SUMMERS, *supra* note 12, §§ 23-2 to 23-4, at 902-17.

14. For illustrations of cases in which the Code specifies an exception, see U.C.C. § 9-201 comment (1978).

15. Certain types of transactions are excluded from the scope of article 9. *Id.* § 9-104. In

ence to the Code's priority provisions when one claimant occupies the status of a secured party. These provisions govern the relative priorities to be accorded a secured party and others who assert an interest in the same collateral.¹⁶ The provisions of article 9 make it clear that a secured party's position vis-a-vis other claimants will be improved if he has taken proper steps to perfect his interest prior to the moment at which a conflicting claim is made.¹⁷ Perfection¹⁸ is intended in most cases to provide notice to potential creditors that the debtor's property is subject to the asserted security interest and that the debtor thus has neither unfettered control over the property nor the unencumbered right to dispose of it.

Two methods of perfection accomplish the notice objective more effectively than others and therefore are preferred under the Code.¹⁹

addition, if a claim to property does not qualify as an article 9 security interest, the priority it will be accorded may be determined by reference to non-Code law. *See, e.g., id.* § 9-310 (requiring reference to the pertinent statute for resolution of status of a statutory lien).

16. Other persons who assert an interest in the collateral may include a holder of paper representing rights in the collateral, *id.* §§ 9-308, 9-309, one with an interest in real estate to which the collateral has been affixed, *id.* § 9-313, or a lienholder or other "purchaser" of the collateral, *id.* § 9-301. The term "purchaser" is defined broadly in the Code to include mortgagees, lien creditors, and donees as well as buyers. *See id.* § 1-201(32), (33).

Priority conflicts may be resolved by reference to §§ 9-201, 9-301, and 9-306 to 9-316. *See* Special Project, *The Priority Rules of Article Nine*, 62 CORNELL L. REV. 834 (1977). When two secured parties claim an interest in the same collateral, their respective rights will usually be determined by reference to § 9-312(5): The first party to file a financing statement or to perfect his security interest in the collateral, *whichever is earlier*, will prevail. Note, however, that this general provision is qualified by a number of exceptions. *See, e.g., U.C.C.* § 9-312(2), (4) (1978).

17. Section 9-301 lists persons whose claims will have priority over an unperfected security interest. The language of § 9-301, "an unperfected security interest is subordinate to [such claims]," gives rise to an inference that *perfected* security interests will not be subordinated in this manner. J. WHITE & R. SUMMERS, *supra* note 12, § 25-2, at 1031 ("by negative implication . . . a perfected secured creditor beats a lien creditor"). Of course, this conclusion may also be reached by reference to § 9-201, which gives effect to any security interest in the absence of an applicable exception in the Code.

Although the Code does not expressly so state, an unperfected security interest will also lose out to a perfected one. *See* D. WHALEY, *PROBLEMS AND MATERIALS ON SECURED TRANSACTIONS* 148 (1982); *U.C.C.* § 9-301 comment 2 (1978).

A perfected security interest may still become subordinate to other interests. As a general rule, however, the perfected secured party is protected against creditors and transferees of the debtor and, in particular, against any representatives of creditors in a debtor's insolvency proceeding. *Id.* § 9-303 comment 1.

18. Under the Code, a security interest may be perfected by the filing of a financing statement, *id.* § 9-302, or by taking possession of the collateral. *Id.* § 9-305. In addition, perfection will be deemed to occur automatically in some instances. *See, e.g., id.* §§ 9-302(1)(d), 9-306(4), (5).

19. Filing of a financing statement and possession of the collateral both provide notice to third parties of a possible claim to the collateral, thereby calling for further inquiry.

Code drafters believed that, to have the rights of a perfected secured creditor one should in the normal course of events undertake some action, either filing or posses-

Either a pledge of the collateral, by which the secured party takes possession of the debtor's property, or the filing of a financing statement by the secured party in the designated office²⁰ will be favored as giving readily available and relatively unambiguous notice to others who might consider lending against the property of the debtor. Of these two, the process of filing is somewhat favored because it is more efficient, less ambiguous, and consistent with the Code's policy of promoting centralized and certain recordkeeping of security interests.²¹

In prescribing the methods of creating and perfecting a security interest, and in according priority to secured parties who act to perfect first,²² article 9 effectuates three fundamental policies. First, the use of secured credit should be facilitated to promote economic growth; without the availability of an effective security interest in collateral, many vital credit sources would dry up.²³ Second, one who extends credit relying on the availability of collateral should be provided a measure of protection and should be allowed certain advantages vis-a-vis other claimants with interests in that collateral.²⁴ Finally, in assessing the priorities given to various property claimants, weight should be given to evidence that a particular party has acted reasonably, diligently, and in good faith.²⁵

sion, which would put a diligent searcher on notice of the secured party's claim. The drafters also wished to increase the certainty that a good faith effort at filing would successfully communicate all necessary information and that a good faith search would reveal the presence of the secured creditor's claim.

J. WHITE & R. SUMMERS, *supra* note 12, § 23-5, at 918-19.

20. See U.C.C. § 9-401(1) (1978).

21. Section 9-302(1) states in part that "[a] financing statement must be filed to perfect all security interests except the following." As a general rule, then, perfection *requires* a filed financing statement unless an exception can be found. See B. CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* ¶ 2.8[1], at 2-27 (1980) ("Perfection by filing is the norm under Article 9 . . .").

22. The general rule governing priority conflicts between two secured creditors is provided in § 9-312(5). This general rule is subject to the exceptions set forth in subsections (2), (3), and (4) of § 9-312. Section 9-312(5), however, embraces the majority of priority disputes, J. WHITE & R. SUMMERS, *supra* note 12, § 25-3, at 1035-36, and resolves those disputes on the exclusive basis of timing. "[T]he subsection is a 'pure race' statute. That is, the one who wins the 'race' to the court house to file is superior . . ." *Id.* § 25-4, at 1037.

23. "[W]e may conclude that the legal system, through provision for and protection of security interests, significantly stimulates the economy by making money available to borrowers and credit buyers which would not otherwise be available." R. SPEIDEL, R. SUMMERS & J. WHITE, *TEACHING MATERIALS ON COMMERCIAL AND CONSUMER LAW* 74 (3d ed. 1981).

24. For a discussion of the policies underlying the priority provisions of article 9, including considerations of certainty, efficiency, and fairness and the interest in protecting reasonable commercial reliance, see B. CLARK, *supra* note 21, ¶ 3.1[2], at 3-4 to 3-6.

25. The general proposition that a party acting reasonably, diligently, and in good faith will be given protection is best illustrated by the Code's treatment of the buyer in the ordinary

Rules of Priority: Secured Parties and Buyers of Used Goods

Consistent with the broad policies enumerated above, article 9 contains a number of provisions intended to protect buyers of goods from loss that would otherwise result from enforcement of a previously created security interest. It must be noted, however, that this protection is granted within the context of section 9-201's presumption that the original security agreement is valid "except as otherwise provided by this Act." Section 9-201, therefore, remains the starting point for discussion of all priority disputes: the security agreement is effective against purchasers unless an exception can be found in the Code.

Section 9-306(2) deals specifically with the rights of the secured party when the debtor disposes of the collateral. Like section 9-201, it creates a presumption that the secured party will have priority. However, the exceptions that it allows are more limited than those of section 9-201: "Except where *this Article* otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor."²⁶ Thus, as a general rule, when claims are asserted by both a creditor with a security interest in specific goods and a buyer of those goods, the secured party will prevail unless either the secured party authorized his debtor's disposition of the goods "in the security agreement or otherwise," or some

course of business in §§ 9-307(1) and 1-201(9). Under § 9-307(1), a buyer in ordinary course takes free of a security interest created by his seller even though the security interest was perfected and the buyer knew of the existence of the security interest. Section 1-201(9) defines a "buyer in ordinary course" as a "person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods." Read in conjunction, these sections mean that a buyer can take free of the seller's security interest so long as he buys in good faith; it is possible to purchase goods in good faith even though one knows of the existence of a prior perfected security interest. This principle has been adopted by most courts. See, e.g., *Frank Davis Buick AMC-Jeep, Inc. v. First Alabama Bank*, 423 So. 2d 855, 35 U.C.C. Rep. Serv. (Callaghan) 249 (Ala. Civ. App. 1982) (allowing a dealer who purchased a jeep from another dealer to qualify as a buyer in ordinary course, despite his failure to search for outstanding security interests; the subjective standard of good faith in § 1-201(9) does not require an exhaustive search for filed security interests); *Bank of Utica v. Castle Ford, Inc.*, 36 A.D.2d 6, 317 N.Y.S.2d 542, 8 U.C.C. Rep. Serv. (Callaghan) 910 (N.Y. App. Div. 1971) (allowing a dealer who purchased automobiles from another dealer to qualify as a buyer in ordinary course; the court found that the buyer had acted in good faith by taking his seller's word that the car was free of any security interest, even though the buyer failed to search the official records for filed financing statements).

26. U.C.C. § 9-306(2) (1978) (emphasis added). The secured party may claim both the collateral itself and any proceeds received upon disposition of the collateral, but may, of course, receive only one satisfaction. *Id.* comment 3.

provision in article 9 “otherwise provides.” Given the language of section 9-306(2), an exception appearing elsewhere in the Code will not affect the secured creditor’s priority.²⁷

Express Protection of Buyers of Goods Under Section 9-307

In cases involving security interests in goods, article 9 “otherwise provides”—that is, specifically allows a purchaser of goods to take those goods free of an asserted security interest—in sections 9-307(1) and (2).²⁸ These provisions are designed to override the earlier presumption in favor of a creditor with a properly created and perfected security interest in the subject collateral and to protect the interests of an innocent buyer who has acquired an interest in such collateral without notice that the transfer to her is wrongful under the terms of an existing security agreement. Neither of these subsections, however, provides adequate protection to a buyer of goods subject to a previously created security interest.

Section 9-307(1) provides that “[a] buyer in ordinary course of business . . . takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.” A “buyer in ordinary course” is defined in section 1-201(9) as one who buys goods in the ordinary course²⁹ from a person engaged in the business of selling goods of that kind,³⁰ and who buys in good faith

27. See *infra* notes 113-15 & accompanying text.

28. See also U.C.C. § 9-301 (1978).

29. The term “ordinary course of business” is not defined in the Code, but may be taken to mean that *all* aspects of the sale are ordinary or usual. A transaction may fail to qualify as one in the ordinary course of business if the sale was made at a *place* other than the regular place of business of one or both of the parties, *see, e.g.*, Rhode Island Hosp. Trust Co. v. Leo’s Used Car Exch., Inc., 314 F. Supp. 254, 8 U.C.C. Rep. Serv. (Callaghan) 93 (D. Mass. 1970) (sale occurred in a state in which neither buyer nor seller regularly transacted business); when the sale was a sham transaction intended for some purpose other than the mere exchange of goods for money, *see, e.g.*, Sierra Fin. Corp. v. Brooks-Farrer Co., 15 Cal. App. 3d 698, 93 Cal. Rptr. 422, 8 U.C.C. Rep. Serv. (Callaghan) 1125 (1971) (sale was for the purpose of bolstering the financially troubled seller and facilitating the buyer’s attempt to gain control of the seller’s business); when the sale price was inadequate, *see, e.g.*, Morey Mach. Co. v. Great W. Indus. Mach. Co., 507 F.2d 987, 16 U.C.C. Rep. Serv. (Callaghan) 489 (5th Cir. 1975); and when the seller and buyer were so closely connected as to negate any presumption of an arms-length transaction, *see, e.g., id.*; Taylor Motor Rental, Inc. v. Associates Discount Corp., 196 Pa. Super. 182, 173 A.2d 688, 1 U.C.C. Rep. Serv. (Callaghan) 539 (1961) (parties shared common officers, shareholders, and employees). See *generally* Annot., 87 A.L.R.3d 11, 71-76 (1978). As to whether a transaction between merchants may be deemed to be in the ordinary course of business, see Note, *Uniform Commercial Code—Secured Transactions—Article 2 Definition of “Good Faith” Not Applicable to Merchant-Buyer Under Section 9-307(1)*, 10 GA. ST. B.J. 110, 112-13 (1973) (suggesting that the answer is “yes” but that the matter is not wholly free from doubt). See also cases cited *infra* note 59.

30. The requirement that the ordinary course buyer buy from one “engaged in the business of selling goods of that kind” will normally be satisfied by a purchase of inventory from a

without knowledge that the sale to him is in violation of the property rights or security interest of a third party.³¹ This definition embraces one who buys goods in the regular course of business from a retail merchant and who has no reason to know that the sale violates the terms of the merchant's agreement with a financier. Such a buyer will take free of an existing security interest pursuant to the terms of section 9-307(1), so long as the interest was "created by his seller." By implication, therefore, a security interest granted by one other than the buyer's seller—such as the seller's own transferor—will remain effective against the ultimate purchaser of the goods.³² Section 9-307(1) thus cannot afford protection to one who buys used goods from any seller subject to a previously created security interest.

The second exception to section 9-306(2), found in section 9-307(2), also will be of no use to one who buys previously encumbered used goods from a merchant. Section 9-307(2) provides:

In the case of consumer goods, a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes unless prior to the purchase the secured party has filed a financing statement covering such goods.³³

For this analysis, the most significant portion of the language employed here, "[i]n the case of consumer goods," has been consistently

retail merchant. Cf. U.C.C. § 2-104(1) (1978). Retailers who purchase from jobbers or manufacturers may also acquire the status of buyer in ordinary course. Application of this requirement is less clear, however, when the seller is an automobile or van rental company that sells previously leased vehicles. At least one court has held that such a company is "engaged in the business of selling" so that its buyer is a buyer in ordinary course of business. *Finance Am. Commercial Corp. v. Econo Coach, Inc.*, 118 Ill. App. 3d 385, 454 N.E.2d 1127, 37 U.C.C. Rep. Serv. (Callaghan) 957 (1983) (where the sale of previously leased vehicles was a known practice among leasing agencies and the seller had a substantial inventory of leased vehicles available for sale, the fact that a significant part of the seller's business was leasing did not preclude status as a seller "engaged in the business of selling"). For contrary decisions, see *United Carolina Bank v. Capital Auto. Co., Inc.*, 163 Ga. App. 796, 294 S.E.2d 661, 34 U.C.C. Rep. Serv. (Callaghan) 1705 (1982); *Hempstead Bank v. Andy's Car Rental Sys., Inc.*, 35 A.D.2d 35, 312 N.Y.S.2d 317, 7 U.C.C. Rep. Serv. (Callaghan) 932 (1970).

31. Buyer in ordinary course status is not jeopardized if the buyer knows of the existence of a valid security interest in the goods sold, unless she also knows that the sale to her violates the terms of the applicable security agreement. U.C.C. § 9-307 comment 2 (1978) ("[T]he buyer takes free if he merely knows that there is a security interest which covers the goods but takes subject if he knows, in addition, that the sale is in violation of some term in the security agreement . . ."); see also B. CLARK, *supra* note 21, ¶ 3.4, at 3-18 (noting that situations in which a dealer is forbidden to sell are rare, "since the purpose of an inventory loan is to finance ongoing retail sales by the dealer").

32. Knapp, *supra* note 7, at 877; Vernon, *supra* note 7, at 531, 535. For a discussion of the history of the "created by his seller" limitation in § 9-307(1), see Knapp, *supra* note 7, at 877-78 n.89.

33. U.C.C. § 9-307(2) (1978).

construed to encompass only transactions between a consumer buyer and a consumer seller. In other words, the goods not only must be purchased for personal, family, or household purposes, but also must have qualified as consumer goods in the hands of the transferor.³⁴ Section 9-307(2) will not apply to a purchase of goods from a merchant because such goods are inventory, not consumer goods, in the hands of the transferor.³⁵

The effect of the Code provisions governing priority conflicts between buyers of goods and secured parties is to expose buyers of goods to possible loss when a claim is asserted on the basis of a previously created security interest. Absent some applicable exception to the general rule, the security interest in the goods remains effective "notwithstanding sale, exchange or other disposition."³⁶ The continued enforceability of the security interest in turn allows the secured party to seek, upon a default by the original debtor,³⁷ the full panoply of remedies afforded by part five of article 9,³⁸ including the right to repossess the collateral,³⁹ wherever it may be found,⁴⁰ and to sell it to satisfy the debt,⁴¹ or to repossess and

34. *General Motors Acceptance Corp. v. Troville*, 6 U.C.C. Rep. Serv. (Callaghan) 409 (Mass. App. Ct. 1969); *Everett Nat'l Bank v. DeSchuiteneer*, 109 N.H. 112, 244 A.2d 196, 5 U.C.C. Rep. Serv. (Callaghan) 561 (1968); *Muir v. Jefferson Credit Corp.*, 108 N.J. Super. 586, 262 A.2d 33, 7 U.C.C. Rep. Serv. (Callaghan) 273 (1970); see also B. CLARK, *supra* note 21, ¶ 3.4[5], at 3-25; 2 G. GILMORE, *supra* note 12, § 26.12, at 716 (section 9-307(2) applies only to sales by amateurs to amateurs); J. WHITE & R. SUMMERS, *supra* note 12, § 25-14, at 1071-73; Dugan, *supra* note 6, at 338 n.16. For a vociferous argument to the effect that § 9-307(2) should not be so restrictively construed, see Skilton, *supra* note 6, at 56-62.

35. In those cases in which § 9-307(2) is applied, moreover, a buyer who satisfies all requisites of that provision is entitled to somewhat limited protection. The buyer takes free of a previously created security interest only if no financing statement covering the goods has been filed.

36. U.C.C. § 9-306(2) (1978). For an excellent discussion of the rights of a secured party against buyers of the collateral, see Wechsler, *Rights and Remedies of the Secured Party After an Unauthorized Transfer of Collateral: A Proposal for Balancing Competing Claims in Repossession, Resale, Proceeds and Conversion Cases*, 32 BUFFALO L. REV. 373 (1983).

37. "Default" is not defined in the Code, but is deemed to encompass a multitude of sins. See Squillante, *Random Comments on Repossession Under the Uniform Commercial Code: Part I*, 74 COM. L.J. 17 (1969), for a thorough discussion of the difficulties encountered in defining the term. Professor Squillante observes that "default is broadly defined by the various courts as a failure by the debtor to perform his obligation which by law must be performed or by contract must be performed." *Id.*

38. See generally U.C.C. §§ 9-501 to 9-507 (1978).

39. *Id.* § 9-503.

40. This result is, of course, the natural implication of § 9-306(2). To the extent that the security interest continues in the collateral notwithstanding disposition, the interest is enforceable against the specific goods constituting the collateral, even if the goods are in the hands of a third party, unless a Code exception comes into play. J. WHITE & R. SUMMERS, *supra* note 12, § 26-7, at 1103.

41. U.C.C. § 9-504 (1978).

retain the collateral in satisfaction of the entire obligation.⁴² In addition, the secured party may seek to impose liability on the beleaguered purchaser in an action for conversion.⁴³

To the extent that the purchaser incurs loss by reason of the asserted security interest, recovery may be available against her seller in an action for breach of the warranty of good title,⁴⁴ but only if that intermediate seller is neither absent nor insolvent.⁴⁵ Moreover, even if a solvent seller can be found, the burden clearly will rest on the ultimate purchaser to initiate the action and, pending resolution of the suit, to continue to bear

42. *Id.* § 9-505.

43. 4 R. ANDERSON, ANDERSON ON THE UNIFORM COMMERCIAL CODE § 9-307:6 (2d ed. 1971). In *Hartford Fin. Corp. v. Burns*, 96 Cal. App. 3d 591, 158 Cal. Rptr. 169, 27 U.C.C. Rep. Serv. (Callaghan) 843 (1979), the plaintiff-financing company made loans and advances to Marler Trucking, retaining a security interest in trucks owned by Marler. After Marler had defaulted on its loan to the plaintiff, Marler's business premises and personalty were seized by its landlord for nonpayment of rent. The landlord's refusal to relinquish the collateral to plaintiff until the rent was paid was held sufficient to entitle plaintiff to recover damages in conversion. Liability was predicated upon the court's finding that the defendant landlord "intended to and did exercise ownership over the personal property herein involved in order to preclude the plaintiff from taking possession of it." *Id.* at 602, 158 Cal. Rptr. at 174.

The *Burns* court allowed enforcement of the security interest even though the plaintiff had concededly failed to perfect that interest in the manner required by the state motor vehicle law. For examples of cases in which perfected secured creditors have been permitted to recover in conversion from third-party purchasers of the collateral, see *United States v. Gallatin Livestock Auction, Inc.*, 448 F. Supp. 616, 24 U.C.C. Rep. Serv. (Callaghan) 219 (W.D. Mo. 1978) (auctioneer who sold cattle in which the Farmers Home Administration had perfected security interest and who remitted the proceeds to the debtor held liable in conversion); *Get It Kwik of Am., Inc. v. First Alabama Bank*, 361 So. 2d 568, 24 U.C.C. Rep. Serv. (Callaghan) 944 (Ala. Civ. App. 1978) (where debtor made unauthorized sale of inventory to third party buyer and buyer resold the inventory, bank that had a perfected security interest in the inventory was held entitled to maintain an action against buyer in conversion); *Prime Business Co. v. Drinkwater*, 350 Mass. 642, 216 N.E.2d 105, 3 U.C.C. Rep. Serv. (Callaghan) 441 (1966) (purchase from debtor of bulldozer in which plaintiff had a perfected security interest constituted conversion). For authority holding that one who fails to perfect his security interest cannot maintain an action against a third party in conversion, see *Strevell-Paterson Fin. Co. v. May*, 77 N.M. 331, 422 P.2d 366, 3 U.C.C. Rep. Serv. (Callaghan) 1094 (1967). The conversion liability of a third party purchaser is not dependent upon the defendant's fault or negligence, but arises as well in instances when the purchaser had no actual knowledge of the existence of the outstanding security interest, but had constructive notice. See *Farmer's State Bank v. Stewart*, 454 S.W.2d 908, 915, 7 U.C.C. Rep. Serv. (Callaghan) 1367, 1371 (Mo. 1970).

44. U.C.C. § 2-312(1)(b) (1978); see *infra* note 53.

45. See Knapp, *supra* note 7, at 887. The intermediate seller is, of course, a "purchaser" within the meaning of § 9-201. This seller's rights are thus also subordinate to those of a party with a previously created interest, unless the secured party has failed to perfect his interest and unless the facts indicate authorization, waiver, or estoppel. Even if the collateral has already been sold by the intermediate seller, the security interest may still be enforced against identifiable proceeds in the seller's hands, as provided by § 9-306. Dugan, *supra* note 6, at 351. For a discussion of authorization, waiver, and estoppel as exceptions to the general rule of purchaser vulnerability, see *infra* notes 71-94 & accompanying text.

the loss.⁴⁶

The Code's treatment of purchasers vis-a-vis secured parties in this situation allocates the risk of a debtor's improper conduct to the buyer in most circumstances.⁴⁷ This allocation of risk produces a "harsh and anomalous" result,⁴⁸ which is inconsistent with the Code's general policy favoring good faith purchasers for value.⁴⁹ Considerations of Code policy as well as matters of equity, conscience, and economic and social reality raise compelling arguments for a scheme offering greater protection to buyers of goods.⁵⁰

In the first instance, it is appropriate to note that the purchaser who is in need of protection is an innocent party, by hypothesis a "buyer in ordinary course of business."⁵¹ As such, she is "a fortiori innocent of any wrongdoing or of any knowledge at the time of the sale that the sale to her was wrongful."⁵² Every such buyer has a legitimate expectation of acquiring good title.⁵³ This expectation, acknowledged in the Code's pro-

46. It has been acknowledged that the operation of the Code's provisions creates certain emotional and economic dislocation for the buyer who finds himself the loser in a battle with a prior encumbrancer. Dugan, *supra* note 6, at 362; Knapp, *supra* note 7, at 889-90.

47. "[Under] the risk allocation implicit in the Code's buyer-secured party priority system [,] . . . the buyer alone bears the risk of the debtor's noncompliance with the terms of the security agreement." Dugan, *supra* note 6, at 344. This risk allocation will shift ultimately to the intermediate seller if he is neither absent nor insolvent. *See infra* text accompanying note 68. The risk will rest with the secured party rather than the ultimate purchaser if the debtor's disposition is found to have been "authorized," *see infra* notes 81-109 & accompanying text, or if § 9-307(1) or 9-307(2) is applicable.

48. Dugan, *supra* note 6, at 346. The limitation on the applicability of § 9-307(1) to security interests "created by [the buyer's] seller" (emphasis added) has been criticized as "unjustifiable and improper." Vernon, *supra* note 7, at 536; *see also* Dugan, *supra* note 6, at 347 ("[I]t is difficult to perceive any compelling justification for the prevailing interpretation of the created-by-his-seller language in Section 9-307(1).").

49. A buyer in ordinary course of business will always be a good faith purchaser for value. The converse is not always true. *See infra* note 98; *cf.* U.C.C. §§ 1-201(9), (19), (32), (44) (1978).

50. *See infra* notes 51-70 & accompanying text.

51. *See supra* notes 30-31 & accompanying text.

52. Knapp, *supra* note 7, at 887.

53. *Id.* It should be noted, in fact, that unless otherwise agreed, every sale of goods carries with it a warranty of good title. U.C.C. § 2-312(1) (1978). This warranty means, *inter alia*, that the goods are not encumbered by any lien, security interest, or other claim undisclosed at the time of sale. *Id.* § 2-312(1)(b). Presumably, a buyer is entitled to rely upon the market nature of the transaction and is not required to undertake extensive investigations into the bona fides of the title to the goods prior to purchase. This policy is also reflected in § 9-307(1): Although retail sellers regularly grant security interests in their inventory to financing institutions, a buyer in ordinary course will "take [the goods] free" of any security interest which has been "created by his seller."

Similarly, under § 2-403(1), a person with voidable title has the power to transfer good title to a good faith purchaser for value. Implicit in this provision is the understanding that one who buys goods under circumstances that do not give rise to suspicion may successfully

vision of a warranty of good title,⁵⁴ is an integral part of the market transaction and therefore worthy of preservation: "Protection of good faith expectations, whether they relate to quality or title, is essential to maximize the market flow of goods which constitutes the long-term basis of the secured party's own economic well being."⁵⁵ By virtue of this expectation, the buyer, and particularly a consumer buyer, is unlikely to consider the possibility that the goods she purchases are encumbered by a valid security interest and thus is unlikely to act to protect herself against this possibility by searching for a previously filed financing statement or by conducting any other investigation.⁵⁶ Even if she were to undertake the task of ascertaining the true facts concerning title, she would lack access to the information necessary to identify the original debtor or the secured party involved.⁵⁷

Section 9-307(1) produces several anomalous results. First, although this provision purports to recognize the merit of insulating from prior claims one who buys from a merchant, it does not operate uniformly to accomplish this purpose. It is clear that section 9-307(1) will not shelter all such buyers from the assertion of a security interest, but only protects a buyer when the conflicting interest was created by his

cut off the claim of another party, so long as that claim is not tantamount to one of "void title" on the part of the transferor. More significantly, the power to cut off prior claims is clearly tied to the nature of the transaction as one "in ordinary course" where, therefore, reliance of a purchaser is legitimate and justified.

Considerations of justifiable or reasonable reliance by a purchaser should be entitled to similar weight in situations in which, as here, the purchaser of used goods confronts the claim of a remote secured party. "The good-title expectations of [a subsequent purchaser] are precisely the same as those which otherwise prompt severance of seller-created liens in inventory [under §§ 9-307(1), 2-403(2)]." Dugan, *supra* note 6, at 346. For a discussion of the possible applicability of § 2-403 to priority conflicts of this type, see *infra* notes 96-131 & accompanying text.

54. U.C.C. § 2-312(1) (1978).

55. Dugan, *supra* note 6, at 362.

56. *Cf.* Knapp, *supra* note 7, at 861-62.

57. However unlikely it may be that she will avail herself of this power, any buyer can by searching the public records discover outstanding security interests granted by her seller. Where a security interest has been created by one other than her seller, . . . the buyer not only will not know the name of that debtor, she probably will have no way of finding it out. There is thus absolutely no reason to expect the buyer to protect herself against such an interest by searching the record; in this regard, she bears even less responsibility in fact for the resulting loss than does the [buyer in ordinary course] now protected by the statute.

Id. at 887 (emphasis added). This problem is, of course, exacerbated when motor vehicles or other substantial consumer goods are purchased, since such goods may be moved across state lines with regularity. A requirement that the security interest be perfected by notation on a certificate of title may reduce the risk to an ultimate purchaser, but will not eliminate it. Dugan, *supra* note 6, at 347 & n.46.

seller. Given the significant policy consideration favoring the free flow of goods that underlies section 9-307(1),⁵⁸ this inconsistency appears unjustifiable.

Second, application of the section will result only fortuitously in protection of consumer buyers, although they have the greatest need for that protection. Because a merchant may qualify as a buyer in ordinary course,⁵⁹ a merchant buyer often will take free of a security interest created by his seller. It is at least possible, however, that, in a subsequent sale to a consumer, the consumer will remain subject to that previously created interest.⁶⁰ A consumer buyer is substantially less likely than a merchant to approach a sales transaction with suspicion, has significantly less sophistication in matters of business, and normally lacks access to information that would reveal the existence of any outstanding security

58. Skilton, *supra* note 6, at 3-4.

59. It has been held that a merchant who purchases goods for resale may qualify as a buyer in ordinary course of business. See *General Elec. Credit Corp. v. Humble*, 532 F. Supp. 703, 33 U.C.C. Rep. Serv. (Callaghan) 394 (M.D. Ala. 1982); *Taft v. Jake Kaplan, Ltd.*, 28 U.C.C. Rep. Serv. (Callaghan) 253 (Bankr. D.R.I. 1980); *Cessna Fin. Corp. v. Skyways Enters. Inc.*, 580 S.W.2d 491, 26 U.C.C. Rep. Serv. (Callaghan) 212 (Ky. 1979); *Medico Leasing Co. v. Smith*, 457 P.2d 548, 6 U.C.C. Rep. Serv. (Callaghan) 786 (Okla. 1969); *Associates Discount Corp. v. Rattan Chevrolet, Inc.*, 462 S.W.2d 546, 8 U.C.C. Rep. Serv. (Callaghan) 117 (Tex. 1970); see also *Massey-Ferguson, Inc. v. Helland*, 105 Ill. App. 3d 648, 434 N.E.2d 295, 33 U.C.C. Rep. Serv. (Callaghan) 1532 (1982).

60. This result follows if it is assumed that every buyer must find a protective exception in article 9 to the rule that the security interest continues, or be subject to the secured creditor's claim against the collateral. This assumption directly violates the so-called shelter principle, which states that each transferee acquires the rights of his transferor. Dolan, *The U.C.C. Framework: Conveyancing Principles and Property Interests*, 59 B.U.L. REV. 811, 812 (1979). Nevertheless, the assumption would be justifiable by reference to the express language of § 9-306(2). See generally *supra* notes 26-27 & accompanying text; *infra* notes 113-15 & accompanying text.

Under § 1-103, common law principles are applicable to Code questions, although those principles are not expressly stated in the Code, if they have not been "displaced" by Code provisions. The critical question thus becomes whether the language in § 9-306(2), "[e]xcept as otherwise provided in this Article," has displaced the shelter rule. An analogous question, which has produced much case law, is the extent to which promissory estoppel may be allowed to defeat reliance upon the Code's statute of frauds, where the Code requires compliance with its express requirements "[e]xcept as otherwise provided in this section." U.C.C. § 2-201(1) (1978) (emphasis added). Section 2-201 makes no reference to promissory estoppel. Although courts considering the issue have not agreed upon the resolution, it appears that a majority have taken the position that the doctrine of promissory estoppel has not been displaced by the language of § 2-201. See, e.g., *Allen M. Campbell Co. v. Virginia Metal Indus., Inc.*, 708 F.2d 930 (4th Cir. 1983); *Warder & Lee Elevator, Inc. v. Britten*, 274 N.W.2d 339 (Iowa 1979); *Potter v. Hatter Farms, Inc.*, 56 Or. App. 254, 641 P.2d 628 (1982); see also Summers, *General Equitable Principles Under Section 1-103 of the Uniform Commercial Code*, 72 Nw. U.L. REV. 906, 912 (1978) (suggesting that the process by which the Code was drafted may account for the omission of references to relevant equitable principles). But see *Lige Dickson Co. v. Union Oil Co.*, 96 Wash. 291, 635 P.2d 103 (1981).

interest.⁶¹ In terms of the relative equities, therefore, there is no basis for providing the first buyer in ordinary course, the merchant, more protection than the second buyer in ordinary course, the consumer.

Finally, section 9-307(1) operates to provide different legal consequences based on whether the goods in the transaction are new or used. As a practical matter, a security interest usually will be "created by [the] seller" only when the goods are new. Therefore, a first-sale purchaser of goods from a retailer is more likely to enjoy the ability to cut off an earlier created security interest than one who buys used goods at retail. It is more likely that used goods will be subject to a previously created security interest. Such a distinction is unjustifiable and inequitable.⁶²

In all probability, section 9-307(1) was intended to apply only to security interests granted by a retailer to his inventory financier.⁶³ Clearly, the section is best suited to this purpose. Serious problems arise when the section is applied to transactions that are factually different but raise equitable considerations that are equally compelling. The limitation of the section, which insulates a buyer only from a security interest "created by his seller," appears to serve no useful function and is inconsistent with the broad Code policy of protecting good faith purchasers for value from assertions of pre-existing claims.

The created-by-his-seller limitation also has been criticized on the ground that, as a matter of policy, the risk of a debtor's treachery ought

61. See *supra* note 57 & accompanying text.

62. A similar anomaly respecting the treatment of buyer-secured party conflicts may be found in transactions involving consumer goods under § 9-307(2). If, for example, no financing statement has been filed by the secured creditor, the immunity granted to a subsequent consumer buyer under § 9-307(2) will depend exclusively upon the accidental event of an intervening sale to a dealer. If all intervening buyers and sellers are consumers, § 9-307(2) will operate to cut off the security interest. If, however, the goods are in the hands of a merchant prior to the last sale, the goods lose their character as consumer goods and § 9-307(2) becomes inoperative.

One commentator has noted:

Where a secured party chooses to perfect by attachment rather than by filing (under the filing exemption for purchase money security interests in consumer goods), it thereby assumes the risk that its consumer-debtor will dispose of the collateral to another consumer-buyer, cutting off the security interest. If the goods do end up in the hands of such a consumer-buyer, . . . loss of the secured party's interest would not exceed the risk it assumed. Furthermore, in this case the ultimate buyer could not—even if she knew enough to try—discover from any record available to her the existence of the outstanding interest. Here then is the clearest case for a result different from that presently dictated by the statute: the fortuitous intervention of a dealer as the third party in a four-party transaction should not deprive the ultimate consumer-[buyer in ordinary course] of protection, where the added party has no impact at all on the relative equities of the secured party and the ultimate buyer.

Knapp, *supra* note 7, at 885.

63. See Dugan, *supra* note 6, at 349.

to rest with the secured creditor rather than with a subsequent purchaser.⁶⁴ The secured party should bear any loss, it is argued, because he is more responsible for causing the loss⁶⁵ and is in a better position to prevent it.⁶⁶ Moreover, as a matter of judicial economy, a rule that allows any buyer in ordinary course to take free of a previously created security interest will avoid circuity of actions.⁶⁷ Any loss initially placed upon the buyer will, in the usual case, ultimately come to rest on the intermediate seller who has breached the warranty of good title:

Where a solvent dealer is available for suit by either the secured party or the buyer, the loss may ultimately fall on that dealer. Assuming that the dealer cannot himself qualify for the [buyer in ordinary course] protection under Section 9-307(1), the dealer will be liable to the secured party for conversion, based on his resale. On the other hand, if the secured party is successful in pursuing the goods in the hands of the buyer, the dealer will be liable to the buyer for breach of warranty of title, express or implied. The ultimate imposition of the loss being the same, there is good reason—particularly where the buyer is a consumer—to free her from the cost and expense of simultaneously defending and prosecuting a lawsuit, by forcing the secured party to sue the dealer directly, receiving as its remedy damages for conversion rather than possession of the goods.⁶⁸

When a solvent intermediate seller cannot be found, imposition of the loss on the secured creditor may still be justified as a matter of “enterprise liability,”⁶⁹ the notion being that this risk can be absorbed more readily by the class of secured creditors and its burden distributed more fairly, via cost adjustments, among members of the class of buyers as a whole.⁷⁰

64. *Id.* at 361; Knapp, *supra* note 7, at 887-91.

65. The policy of the Code is to protect buyers in ordinary course “from the hidden interests of those who voluntarily deal with their property in such a manner that it inevitably enters the stream of commerce.” Dugan, *supra* note 6, at 350-51 (citing U.C.C. § 2-403 comment 2 (1978)).

66. Knapp, *supra* note 7, at 890. As a matter of fairness, it seems inappropriate, therefore, to saddle the ultimate buyer with the loss, rather than to require the secured party to police the collateral more closely and to require the intermediate dealer to trace the origins of trade-ins with greater care. *Id.*

A buyer of a used good may on occasion be viewed as adequately equipped to protect herself from treachery. When a second-hand buyer is offered a \$10,000 car for \$100, for example, the buyer ought to be suspicious and to investigate the bona fides of the transaction. Absent circumstances that dictate cause for suspicion, however, the second buyer is not normally in a better position to guard against loss caused by a debtor's misconduct. *Cf. supra* note 57 & accompanying text.

67. Knapp, *supra* note 7, at 888-89.

68. *Id.* at 888 (footnotes omitted).

69. *Id.* at 889.

70. *Id.* at 890.

Authorized Disposition Protection for Buyers of Goods

An important exception to the buyer vulnerability described above is found in the language of section 9-306(2): A security interest continues in collateral, even following sale or other disposition, "unless the disposition was authorized by the secured party in the security agreement or otherwise." Authorization thus enables a subsequent purchaser to acquire title to goods free of any previously created security interest. Although the Code does not define "authorized," the term has been held to embrace both express language and the permission that may be implied by particular words or conduct of a secured party.⁷¹

Authorization may be granted in the express language of the security agreement itself. Such an express grant to the debtor of permission to dispose of the collateral is rare, except when the collateral is inventory in the hands of the debtor. An inventory financier expects to be repaid out of the proceeds of a sale of the collateral; therefore, the terms of the security agreement usually include an expression of consent to the sale of the inventory in the ordinary course of the debtor's business.⁷² A notation in the agreement that refers to resale also has been held to constitute an express authorization to the debtor to dispose of the collateral. For

71. A definition may be created in part by reference to § 1-201(43), which states that an "unauthorized" signature is "one made without actual, implied or apparent authority." It may thus be inferred that the standards employed under general principles of agency law are applicable to determine the existence of authorization, whether actual, implied or apparent. See generally RESTATEMENT (SECOND) OF AGENCY §§ 7, 8, 8A (1958). "Authorize" means to empower, to give a right to act, or to permit a thing to be done in the future. *People v. Young*, 100 Ill. App. 2d 20, 241 N.E.2d 587 (1968). The Code expressly states that its provisions are to be supplemented by principles of law and equity, including the law relative to principal and agent, unless those principles have been displaced by Code language. U.C.C. § 1-103 (1978).

72. Dolan, *Section 9-307(1): The U.C.C.'s Obstacle to Agricultural Commerce in the Open Market*, 72 NW. U.L. REV. 706, 709 (1977). Authorization is usual when a floor planner of inventory expects the debtor to sell the goods free of the security interest and has no intention of pursuing them into the hands of consumers. *J. WHITE & R. SUMMERS, supra* note 12, § 25-12, at 1066; see, e.g., *Swift & Co. v. Jamestown Nat'l Bank*, 426 F.2d 1099, 7 U.C.C. Rep. Serv. (Callaghan) 788 (8th Cir. 1970) (bank's security agreement expressly authorized sale of cattle); *Commercial Credit Corp. v. National Credit Corp.*, 251 Ark. 541, 473 S.W.2d 876, 10 U.C.C. Rep. Serv. (Callaghan) 232 (1971) (used car dealer's sale of car was expressly authorized by secured party under the trust receipt covering the automobile); *Universal C.I.T. Credit Corp. v. Middlesboro Motor Sales, Inc.*, 424 S.W.2d 409, 4 U.C.C. Rep. Serv. (Callaghan) 1126 (Ky. 1968) (security agreement authorized sale of automobiles in ordinary course of trade); *McFadden v. Mercantile-Safe Deposit & Trust Co.*, 260 Md. 601, 273 A.2d 198, 8 U.C.C. Rep. Serv. (Callaghan) 766 (1971) (where financing statement covered "inventory . . . held for sale," debtor's disposition of collateral was held to have been expressly authorized by the secured party). In fact, when the original collateral is inventory held for sale, an authorization to dispose of the collateral by sale will normally be implied. E. REILEY, *GUIDEBOOK TO SECURITY INTERESTS IN PERSONAL PROPERTY* § 2.5(d), at 2-33 (1981).

example, in *Bank of Beulah v. Chase*,⁷³ the word "Resale" appeared on the face of the contract signed by the lender, the seller, and the debtor covering the debtor's acquisition of a new truck. The notation was held to be an express indication that the lender authorized the resale of the vehicle by the debtor. Express authorization of sale or other disposition may be oral as well as written.⁷⁴

In the absence of express terms that permit the debtor to sell or otherwise to dispose of the collateral, authorization may be found by reference to a course of dealing,⁷⁵ course of performance,⁷⁶ or usage of trade.⁷⁷ Terms implied from a course of dealing, course of performance,

73. 231 N.W.2d 738, 17 U.C.C. Rep. Serv. (Callaghan) 259 (N.D. 1975); *see also* First Fin. Co. v. Akathiotis, 110 Ill. App. 2d 377, 249 N.E.2d 663, 6 U.C.C. Rep. Serv. (Callaghan) 946 (1969) (buyer took free of security interest where security agreement mentioned sales contract).

74. *See* First Nat'l Bank & Trust Co. v. Iowa Beef Processors, Inc., 626 F.2d 764, 29 U.C.C. Rep. Serv. (Callaghan) 743 (10th Cir. 1980); *Security Nat'l Bank v. Belleville Livestock Comm'n Co.*, 619 F.2d 840, 26 U.C.C. Rep. Serv. (Callaghan) 528 (10th Cir. 1979).

75. "A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct." U.C.C. § 1-205(1) (1978). *See* Lisbon Bank & Trust Co. v. Murray, 206 N.W.2d 96, 12 U.C.C. Rep. Serv. (Callaghan) 356 (Iowa 1973) (where farmer sold financed cattle without the bank's knowledge and then defaulted on the loan, the bank's prior course of dealing, permitting sale on condition that the proceeds were timely remitted, was held to constitute waiver of security interest). *But see* Baker Prod. Credit Ass'n v. Long Creek Meat Co., 266 Or. 643, 513 P.2d 1129, 13 U.C.C. Rep. Serv. (Callaghan) 531 (1973) (course of performance between farmer and secured party may constitute a waiver; however, if waiver is conditioned upon receipt of proceeds of sale, failure to remit proceeds renders waiver inoperative).

76. "Course of performance," or the parties' conduct in rendering repeated performances under one particular agreement, may be relevant to determining the meaning of the agreement. U.C.C. § 2-208(1) (1978).

For support for the proposition that a secured party's continued failure to object to the debtor's sale of collateral is tantamount to authorization of such sales, *see* United States v. Central Livestock Ass'n, Inc., 349 F. Supp. 1033, 11 U.C.C. Rep. Serv. (Callaghan) 1054 (D.N.D. 1972) (involving custom, consent, and waiver); *In re Cadwell, Martin Meat Co.*, 10 U.C.C. Rep. Serv. (Callaghan) 710 (E.D. Cal. 1970) (course of conduct); *Planters Prod. Credit Ass'n v. Bowles*, 256 Ark. 1063, 511 S.W.2d 645, 14 U.C.C. Rep. Serv. (Callaghan) 1435 (1974) (course of dealing); *Hedrick Sav. Bank v. Myers*, 229 N.W.2d 252, 16 U.C.C. Rep. Serv. (Callaghan) 1412 (Iowa 1975) (course of dealing); *Lisbon Bank & Trust Co. v. Murray*, 206 N.W.2d 96, 12 U.C.C. Rep. Serv. (Callaghan) 356 (Iowa 1973) (course of dealing); *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726, 4 U.C.C. Rep. Serv. (Callaghan) 137 (1967) (implied consent); *Central Washington Prod. Credit Ass'n v. Baker*, 11 Wash. App. 17, 521 P.2d 226, 14 U.C.C. Rep. Serv. (Callaghan) 1055 (1974) (course of conduct).

77. "A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question." U.C.C. § 1-205(2) (1978). Usage of trade is an important factor to consider in determining whether disposition was authorized. *Hempstead Bank v. Andy's Car Rental Sys., Inc.*, 35 A.D.2d 35, 312 N.Y.S.2d 317, 7 U.C.C. Rep. Serv. (Callaghan) 932 (1970); *see also* Tanbro Fabrics Corp. v. Deering Milliken, Inc., 39 N.Y.2d

or usage of trade may be included as a part of the security agreement,⁷⁸ so long as the implied terms are not inconsistent with the express language of the contract.⁷⁹ Section 1-205(4) provides:

The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade.⁸⁰

Thus, if the security agreement explicitly prohibits disposition of the collateral except upon prior written consent of the lender, an authorization from a course of dealing or usage of trade would seem to contradict the agreement and, therefore, could not be incorporated. In such cases, however, the courts have disagreed as to whether a waiver of the express provision may be implied from the conduct of the parties. To the extent that the agreement purports to preclude evidence of conduct which antedated the contract, the preclusion will likely stand.⁸¹ It should be noted, however, that section 1-205(4) precludes only the use of the two pre-agreement phenomena—course of dealing and usage of trade—to find that the lender has waived the prior written consent requirement. It does not bar a finding that the disposition was authorized by virtue of the

632, 385 N.Y.S.2d 260, 350 N.E.2d 590, 19 U.C.C. Rep. Serv. (Callaghan) 385 (1976) (sale was impliedly authorized where security interest was retained in debtor's finished and unfinished inventory and debtor followed industry practice in selling excess unfinished inventory).

78. The Code defines "agreement" as "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Act (Sections 1-205 and 2-208)." U.C.C. § 1-201(3) (1978); *see also id.* § 1-201 comment 3.

79. *Id.* §§ 1-205(4), 2-208(2).

80. *Id.* § 1-205 (4).

81. It has been recognized that authority to dispose of collateral may be implied. [However,] [t]here is a split of authority on the issue of whether consent to a transfer may be implied when a security agreement expressly provides that collateral may not be transferred without the written consent of the secured party. [While] [s]ome cases have held that a waiver of this provision may be implied from the course of dealings between the parties . . . [the better view is] that when a security agreement requires prior written authorization before collateral may be disposed of by the debtor, authorization cannot be established by a course of dealing [pursuant to U.C.C. § 1-205(4)].

Abney v. Nikko Audio, 2 Bankr. 583, 588, 29 U.C.C. Rep. Serv. (Callaghan) 271, 276 (N.D. Ga. 1980) (citations omitted); *see also Security Nat'l Bank v. Belleville Livestock Comm'n Co.*, 619 F.2d 840, 26 U.C.C. Rep. Serv. (Callaghan) 528 (10th Cir. 1979). *Contra CharterBank Butler v. Central Coops., Inc.*, 667 S.W.2d 463, 38 U.C.C. Rep. Serv. (Callaghan) 354 (Mo. App. 1984) (security interest held waived through course of dealing). *Cf. United States v. Missouri Farmers Assocs., Inc.*, 580 F. Supp. 35, 38 U.C.C. Rep. Serv. (Callaghan) 360 (E.D. Mo. 1984) (secured party's course of dealing in accepting proceeds of unauthorized disposition constituted waiver of security interest, but no waiver resulted when proceeds of later unauthorized sales were not remitted).

parties' course of performance.⁸² Although inconsistent course of performance is also subject to the express terms of the agreement,⁸³ such conduct is still "relevant to show a waiver or modification of any term inconsistent with such course of performance."⁸⁴

In addition to arguments that the security agreement expressly authorized the debtor's disposition of the collateral, so as to cut off the claim of the secured party as to the specific goods sold,⁸⁵ or that a provision purporting to withhold such authorization has been waived,⁸⁶ a buyer who seeks to circumvent a secured party's priority may be able to rely on the doctrine of equitable estoppel.⁸⁷ For example, in *Muir v. Jefferson Credit Corp.*,⁸⁸ the secured party permitted the initial buyer to obtain possession of the motor vehicle certificate of title in violation of a New Jersey statute requiring the secured party to hold the certificate until its lien is discharged. Obtaining the certificate enabled the initial buyer to indicate fraudulently on the certificate that the lien had been satisfied and to sell the car to a dealer who in turn sold it to a buyer in the ordinary course of business. The court held that although the created-by-his-seller limitation would normally apply to preserve the se-

82. Whether or not the security agreement expressly forbids the debtor from disposing of collateral, the secured party may lose his claim if a course of performance has evolved under which the debtor is permitted to sell the collateral. See Dugan, *supra* note 6, at 339-42; see also U.C.C. § 2-208 comment 3 (1978).

For a contrary view, see *Wabasso State Bank v. Caldwell Packing Co.*, 308 Minn. 349, 251 N.W.2d 321, 19 U.C.C. Rep. Serv. (Callaghan) 315 (1976), and cases cited therein. In *Wabasso*, the court refused to find a farmer-debtor's disposition of collateral to be authorized in the face of an express provision requiring bank authorization prior to any sale. Over a period of about eight years, the farmer routinely sold cattle in violation of this provision and remitted the proceeds to the bank as payments on the outstanding debt. The bank was thus aware of the sales, but failed to object. The court, insisting that such bank conduct did not amount to a waiver of the prior consent requirement, relied in substantial part on § 1-205(4). It would appear, however, that the court failed to distinguish "course of dealing" (to which § 1-205(4) applies) and "course of performance," demonstrated by the facts in this case. T. QUINN, UNIFORM COMMERCIAL CODE COMMENTARY AND DIGEST ¶ 9-306[A][13][c] (Cum. Supp. 1983).

83. U.C.C. § 2-208(2) (1978).

84. *Id.* § 2-208(3).

85. The secured party will, of course, retain a valid claim to any identifiable proceeds of the sale under § 9-306(2).

86. See *supra* note 84 & accompanying text.

87. Under this doctrine, one may be precluded because of his conduct from asserting rights that might otherwise have existed. BLACK'S LAW DICTIONARY 483 (rev. 5th ed. 1979). Equitable principles survive the enactment of the Uniform Commercial Code: "Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions." U.C.C. § 1-103 (1978).

88. 108 N.J. Super. 586, 262 A.2d 33, 7 U.C.C. Rep. Serv. (Callaghan) 273 (1970).

cured party's lien against the buyer, the secured party's failure to retain the certificate of title estopped it from asserting its interest.⁸⁹

Despite the many theories available,⁹⁰ a consumer buyer in ordinary course of previously encumbered goods who seeks to avail herself of the authorization exception to section 9-306(2) will likely encounter significant obstacles. When the remote secured party's agreement secures collateral in the hands of a consumer debtor, disposition ordinarily will not be authorized. Unlike inventory lenders, who routinely permit their debtors to dispose of the collateral,⁹¹ consumer lenders neither expect a sale to occur in ordinary course, nor look to the proceeds of such a sale for repayment of the debt.⁹² Authorization outside the four corners of the security agreement, that is, implied from the conduct of the parties, is also unlikely.⁹³ In consumer transactions, there normally will be no course of dealing, course of performance, or usage of trade upon which to predicate an assertion that the secured party's interest has been terminated. Conduct tantamount to the waiver of a prior written consent clause—for example, a pattern of lender acquiescence to sales without written consent or of lender failure to insist upon strict compliance with the terms of the security agreement—is thus lacking in our hypothetical scenario. In addition, because the lender probably will lack knowledge of the debtor's sale to an intermediate dealer, waiver as to this particular disposition is unlikely to be applicable. Finally, because the ultimate

89. *Id.* at 596-97, 262 A.2d at 38-39, 7 U.C.C. Rep. Serv. (Callaghan) at 281-82. There is, however, considerable judicial reluctance to accept claims of estoppel asserted by transferees who seek to take free of security interests. *See, e.g.,* Security Nat'l Bank v. Belleville Livestock Comm'n Co., 619 F.2d 840, 846, 26 U.C.C. Rep. Serv. (Callaghan) 528, 536 (10th Cir. 1979); *Montgomery v. Fuquay-Mouser, Inc.*, 567 S.W.2d 268, 24 U.C.C. Rep. Serv. (Callaghan) 756 (Tex. Civ. App. 1978).

90. For an excellent discussion of the approaches available to the buyer, see Dugan, *supra* note 6, at 339-43.

91. *See supra* note 72 & accompanying text.

92. Therefore, when the collateral is consumer goods, the security agreement normally forbids disposition of the collateral without express written approval. If the loan is not repaid, the consumer lender will prefer to repossess the collateral rather than try to trace the proceeds into the hands of another party.

93. In cases involving collateral other than farm products courts have rarely found authorizations in the absence of an express provision in the security agreement. Nickles, *A Localized Treatise on Secured Transactions—Part II: Creating Security Interests*, 34 ARK. L. REV. 559, 662 n.724 (1981). Yet authority to dispose of collateral can be implied from the conduct of a secured party or inferred from the circumstances of any case regardless of the nature of the collateral, because the "or otherwise" language of § 9-306(2) is not limited to farm products transactions. *See, e.g.,* Platte Valley Bank v. B & J Constr., Inc., 66 Colo. App. 41, 606 P.2d 455, 28 U.C.C. Rep. Serv. (Callaghan) 872 (1980); *Cessna Fin. Corp. v. Skyways Enters., Inc.*, 580 S.W.2d 491, 26 U.C.C. Rep. Serv. (Callaghan) 212 (Ky. 1979); *Poteau State Bank v. Denwalt*, 597 P.2d 756, 26 U.C.C. Rep. Serv. (Callaghan) 1025 (Okla. 1979).

buyer in our case has no knowledge of the previously created security interest, she will probably be unable to show that she has relied upon any previous conduct or silence of the secured party for purposes of establishing an estoppel defense. Of course, absent specific facts supporting authorization, estoppel, or waiver of the secured claim, the buyer will prevail only upon a showing that the Code clearly has created an exception applicable to her.⁹⁴

Applicability of Article 2 in Protecting Buyers of Goods

It has been suggested that a buyer of goods subject to a previously created security interest may circumvent the created-by-his-seller limitation of section 9-307(1) by resort to the provisions of article 2 of the Code. Under section 2-403(1), "[a] person with voidable title has power to transfer a good title to a good faith purchaser for value."⁹⁵ The concept of voidable title implies a distinction between an acquisition of possession of goods in connection with a "transaction of purchase"⁹⁶ and an acquisition of possession by theft. If possession is gained by theft, the thief has "void title" and has no power to transfer good title. If possession is gained by a "transaction of purchase," good title can be transferred to a good faith purchaser for value.⁹⁷ Arguably, when a debtor

94. See *supra* notes 19-25 & accompanying text.

95. U.C.C. § 2-403(1) (1978). Section 2-403(1) also provides that a "purchaser of goods acquires all title which his transferor has or had power to transfer." This section adopts the shelter principle. See Dolan, *supra* note 60, at 812-13. Arguably, this principle could be applied to assist the buyer of used goods in certain situations. To take an example, suppose that a hardware store sells a lawnmower on credit to X, a consumer, and takes a security interest in it. No financing statement would need to be filed to perfect this security interest, U.C.C. § 9-302(1)(d) (1978), and if no financing statement were filed, X's sale to Y, another consumer, would normally operate to cut off the store's security interest, *id.* § 9-307(2). If Y sells the mower to a fourth party, then Y's buyer might also take free of the original security interest even though no exception in article 9 expressly so provides. The underlying rationale of the shelter principle—an interest in facilitating the movement of goods and in ensuring a market of buyers for those goods—affirms the justice of this result. However, the limiting language of § 9-306(2), "[e]xcept as otherwise provided in this Article," seems to preclude this result. *Id.* § 9-306(2) (emphasis added).

96. J. WHITE & R. SUMMERS, *supra* note 12, §§ 3-11, at 140-42.

97. The protection given buyers by § 2-403(1) is based on the equitable principle that a bona fide purchaser from one with voidable title cuts off the right of rescission of the true owner of the property. See *R.H. Macy's N.Y., Inc. v. Equitable Diamond Corp.*, 34 U.C.C. Rep. Serv. (Callaghan) 896 (N.Y. Civ. Ct. 1982) (holding that where passage of title is conditioned on the performance of an act, such as the passing of a check, title is voidable and could be transferred to a third party if that third party was a good faith purchaser for value); *Liles Bros. & Son v. Wright*, 638 S.W.2d 383, 34 U.C.C. Rep. Serv. (Callaghan) 1174 (Tenn. 1982) (stating that an individual who purchased goods with a check that was subsequently dishonored obtained voidable title and was thus able to pass good title to a later good faith purchaser for value). If the title of the intermediate seller is void, however, the true owner retains his

purchases goods and grants a security interest in them to his creditor, he has gained possession in a "transaction of purchase" and, therefore, has the power to transfer good title, severing the claim of the secured party.⁹⁸ If section 2-403(1) and its concept of voidable title does operate to cut off a security interest, it affords substantially greater protection for buyers than is available under section 9-307(1). Section 2-403(1) permits one who cannot qualify as a "buyer in ordinary course" but who nevertheless has the status of a "good faith purchaser"⁹⁹ to acquire superior rights to personalty in those cases in which the transferor's title is not void. Application of section 2-403(1) would also subordinate the claim of a prior secured party to the interests of the buyer even when the security interest is not created by the buyer's seller.¹⁰⁰

Under section 2-403(2), moreover, "[a]ny entrusting of possession of

right of rescission and all incidents of ownership. In this case, the intermediate party cannot pass good title to a subsequent good faith purchaser for value. See *Allstate Ins. Co. v. Estes*, 345 So. 2d 265, 21 U.C.C. Rep. Serv. (Callaghan) 1032 (Miss. 1977) (holding that where car was stolen from true owner, intermediate seller had void title and could not pass good title to a good faith purchaser for value; ownership rights remained with the true owner and were not cut off by the provisions of § 2-403(1)); *Johnny Dell, Inc. v. New York State Police*, 84 Misc. 2d 360, 375 N.Y.S.2d 545, 18 U.C.C. Rep. Serv. (Callaghan) 378 (N.Y. Sup. Ct. 1975) (holding that a good faith purchaser for value from a thief does not acquire good title; § 2-403(1) only operates to transfer to the purchaser the title held by his immediate transferor; therefore, the purchaser would only acquire a thief's title, which was void). For a discussion of the distinction between "voidable" and "void" title, see R. ALDERMAN, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE § 1.53-50 (2d ed. 1983).

98. Dugan, *supra* note 6, at 335, 350 n.62. But see *Western Nat'l Bank v. ABC Drilling Co.*, 599 P.2d 942 (Colo. App. 1979) (purchaser of collateral from debtor, who sold it in violation of terms of a security agreement, lacked rights in collateral, and could not grant valid security interest to another creditor).

99. The Code defines "buyer in ordinary course" in § 1-201(9). The term "good faith purchaser for value" is not defined in the Code, but may be inferred from its component parts. U.C.C. § 1-201(19) (1978) ("good faith" defined); *id.* § 1-201(32) ("purchase" defined); *id.* § 1-201(33) ("purchaser" defined); *id.* § 1-201(44) ("value" defined). One major distinction between these two types of buyers would seem to lie in the level of "good faith" required. In order to qualify as a buyer in ordinary course, a person must act in good faith *and* without knowledge that the sale is in violation of previously created security or ownership interests. *Id.* § 1-201(9). Also, the definition in § 1-201(9) precludes buyer in ordinary course status if the consideration furnished for the goods was the total or partial satisfaction of an antecedent money debt. *Id.* On the other hand, under common-law principles and § 1-201(44), a buyer qualifies as a good-faith purchaser for value if he supplies any valuable consideration reasonably equivalent to the value of the goods received; the receipt of goods in satisfaction of a money debt would clearly satisfy that requirement. Therefore, it is apparent that the status of good faith purchaser is merely one element of the more restrictive definition of the buyer in the ordinary course of business. For a case comparing the requirements of "buyer in ordinary course" status with those of "good faith purchaser for value," see *Atlas Auto Rental Corp. v. Weisberg*, 54 Misc. 2d 168, 281 N.Y.S.2d 400, 4 U.C.C. Rep. Serv. (Callaghan) 572 (N.Y. Civ. Ct. 1967).

100. See Dugan, *supra* note 6, at 345-51.

goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business."¹⁰¹ "Entrusting" is defined to include not only delivery of the goods to a merchant, but also "any acquiescence in retention of possession" regardless of any conditions imposed upon such delivery or acquiescence.¹⁰² Therefore, application of section 2-403(2) would operate to sever a secured party's interest in collateral when the secured party acquiesces in the possession of the collateral by a merchant¹⁰³ who deals in goods of that kind and the merchant sells the collateral to a buyer in ordinary course of business.¹⁰⁴

Because an ordinary course buyer acquires the rights of the entruster under section 2-403(2), the secured creditor's interest would be terminated only if the secured party's conduct is tantamount to entrusting. The secured party doubtless will be found to have acquiesced in the possession of the collateral by his debtor. Although that acquiescence invariably will be conditioned upon compliance with the terms of the security agreement, including the omnipresent clause prohibiting unauthorized disposition of the collateral, such conditions are ineffective under section 2-403(2) to vitiate the delivery or acquiescence.¹⁰⁵ In some situations, the conduct of the secured party will also be held to constitute entrusting to a merchant. In those cases, the later buyer who successfully invokes section 2-403(2) is entitled to all rights of the entrusting secured party and may resist the latter's claim of priority in the goods.

An interesting example of this approach may be found in *Milnes v. General Electric Credit Corp.*¹⁰⁶ In *Milnes*, the Florida Court of Appeals held that when the holder of a security interest entrusts possession of a mobile home to a merchant who deals in goods of that kind and the merchant subsequently sells the vehicle to a buyer in the ordinary course of business, good title to the vehicle is conveyed to the buyer free of the prior lien.¹⁰⁷ The mobile home had originally been purchased under an installment payment plan from a dealer, which assigned the contract to General Electric Credit Corporation (GECC). When the buyers became unable to meet the required payments, they notified GECC of the default and returned the vehicle to the dealer's premises for the purpose of resale. GECC took no steps to foreclose on the security agreement, to re-

101. U.C.C. § 2-403(2) (1978).

102. *Id.* § 2-403(3).

103. *See* Dugan, *supra* note 6, at 348.

104. *Id.*

105. *Id.*

106. 377 So. 2d 725, 27 U.C.C. Rep. Serv. (Callaghan) 1428 (Fla. Dist. Ct. App. 1979).

107. *Id.* at 729, 27 U.C.C. Rep. Serv. (Callaghan) at 1433-34.

possess the motor home, or to object in any way to the removal of the motor home to the dealer.¹⁰⁸ The motor home was subsequently sold by the dealer to the defendants, Mr. and Mrs. Milnes, who also signed a retail installment contract. The dealer immediately assigned the contract to another finance company, which paid cash for the contract rights. The dealer's check to GECC for the amount of its original lien was promptly issued, but was returned for insufficient funds. When the dealer subsequently became insolvent, GECC sought to foreclose on its first lien on the motor home, alleging that the original buyers had defaulted and that GECC was entitled to effect a sale of the motor home to satisfy the debt.

The court applied what it saw as the well-settled rule in Florida, that good title to a motor vehicle is conveyed free of a prior lien when the holder of the lien entrusts possession of the motor vehicle to a merchant who deals in vehicles of that kind and the merchant sells the motor vehicle to a buyer in the ordinary course of business without satisfying the prior lien.¹⁰⁹ The court also noted that this rule applied only when the motor vehicle was entrusted to a merchant who dealt in vehicles of that kind; if the vehicle had been entrusted to a private party, a subsequent sale of the vehicle by the private party without satisfying the prior lien would not convey good title to the vehicle free of the prior lien.¹¹⁰ No reference is made in the decision to any impediment to applying article 2 of the Code.¹¹¹ The effect of this decision apparently is to sever the secured party's claim to the collateral whenever he has knowledge that it is in the possession of a merchant and fails to object, provided, of course, that sale to a buyer in ordinary course of business ensues.

Although the provisions of article 2 thus would seem to supply a

108. *Id.* at 726-27, 27 U.C.C. Rep. Serv. (Callaghan) at 1430-31.

109. *Id.* at 728, 27 U.C.C. Rep. Serv. (Callaghan) at 1432 (citing *Hamilton County Bank v. Tuten*, 250 So. 2d 17, 9 U.C.C. Rep. Serv. (Callaghan) 511 (Fla. Dist. Ct. App. 1971) and *Correria v. Orlando Bank and Trust Co.*, 235 So. 2d 20, 7 U.C.C. Rep. Serv. (Callaghan) 937 (Fla. Dist. Ct. App. 1970)). The transaction in *Milnes* could be analyzed as one involving creditor consent under § 9-306(2) or, alternatively, a sale in ordinary course of business under § 9-307(1). See 377 So. 2d at 729, 27 U.C.C. Rep. Serv. (Callaghan) at 1434. While each of these analyses would produce the same result in this case, application of § 9-307(1) would seem to be erroneous because the security interest was not created by the buyer's seller. See *infra* notes 113-15 & accompanying text.

110. See *Castner v. Ziemer*, 125 So. 2d 134 (Fla. Dist. Ct. App. 1960).

111. For other cases circumventing the created-by-his-seller limitation of § 9-307(1), see *Commercial Credit Corp. v. Associates Discount Corp.*, 246 Ark. 118, 436 S.W.2d 809, 6 U.C.C. Rep. Serv. (Callaghan) 82 (1969); *General Motors Acceptance Corp. v. Keil*, 176 N.W.2d 837, 7 U.C.C. Rep. Serv. (Callaghan) 835 (Iowa 1970); *General Elec. Credit Corp. v. Western Crane & Rigging Co.*, 184 Neb. 212, 166 N.W.2d 409, 6 U.C.C. Rep. Serv. (Callaghan) 67 (1969). See also *infra* note 116 & accompanying text.

source of relief for the buyer against many claims to personalty asserted by remote parties,¹¹² a significant question exists as to the propriety of resolving these cases on the basis of authority outside article 9. The argument that a dispute between the later buyer and the secured party must be governed exclusively by article 9 was well articulated in *National Shawmut Bank v. Jones*.¹¹³ Jones, a consumer, had made a routine purchase of an automobile "for good and sufficient consideration in good faith without any actual knowledge of any security interest."¹¹⁴ The automobile was in fact the subject of a conditional sales contract between the original seller and the original buyer, Wever. Wever had defaulted in his payments and had sold the car to Hanson-Rock, Inc., a dealer in the business of selling new and used cars, which in turn transferred the car to Jones. National Shawmut Bank, the assignee of the conditional sales contract, sought to replevy the car from Jones, claiming that its security interest continued in the collateral notwithstanding the unauthorized disposition by Wever and that Jones did not qualify as a buyer entitled to protection under section 9-307(1) because the security interest was not "created by his seller." The New Hampshire Supreme Court agreed. In response to the argument that section 2-403 should be applied to overcome the bank's claim of priority, the court held that article 2 was inapplicable to the resolution of the dispute. It noted, first, that section 9-306(2) contemplates continuation of the security interest notwithstanding sale "except when this Article otherwise provides," thereby foreclosing consideration of Code sections in some other article. In addition, article 2 itself contains language that purports to require exclusive application of article 9. The court observed:

[Section] 2-402 . . . provides "(3) Nothing in this Article shall be deemed to impair the rights of creditors of the seller . . . under the provisions of the Article on Secured Transactions (Article 9)" It is clear, therefore, that a security interest in the case of a sale without consent was to be impaired only as provided in Article 9 and is unaffected by Article [sic] 2-402.¹¹⁵

Under the *Jones* court's analysis, purchasers of collateral remain subject to any previously created security interest unless an exception can be found within the provisions of article 9. An exception located elsewhere within the Code, however enticing, is inapplicable.

While there is a compelling logic to the *Jones* court's analysis, this

112. See Dugan, *supra* note 6, at 335, for a description of the advantages of § 2-403 over § 9-307.

113. 108 N.H. 386, 236 A.2d 484, 4 U.C.C. Rep. Serv. (Callaghan) 1021 (1967).

114. *Id.* at 387, 236 A.2d at 485, 4 U.C.C. Rep. Serv. (Callaghan) at 1023.

115. *Id.* (quoting U.C.C. § 2-402(3) (1978)).

reasoning has not been applied consistently. In some jurisdictions, the distinction between the two articles has been ignored, and articles 2 and 9 have been treated essentially as interchangeable.¹¹⁶ Certain courts have applied the entrustment provisions of section 2-403(2) to avoid the harsh consequences of the article 9 priority provisions for subsequent buyers without discussion of any potential impediment to this approach in the language of section 9-306(2). When a secured party has entrusted the collateral to a third-party merchant directly,¹¹⁷ an application of article 2

116. J. WHITE & R. SUMMERS, *supra* note 12, § 25-15, at 1073 n.100. A number of decisions have ignored the possible barrier in article 9 to a resort to article 2. In *Sterling Acceptance Co. v. Grimes*, 194 Pa. Super. 503, 168 A.2d 600, 1 U.C.C. Rep. Serv. (Callaghan) 487 (1961), for example, the Superior Court of Pennsylvania allowed the defendant, a purchaser of a car subject to a perfected security interest, to avoid liability to the secured creditor under the authority of § 2-403(2). The court used the entrustment provision of article 2 without discussion of its relationship to article 9.

In *Kapral v. Hanover Nat'l Bank*, 1 U.C.C. Rep. Serv. (Callaghan) 542 (Pa. Ct. C.P. 1962), a Pennsylvania Court of Common Pleas, citing the *Grimes* decision, also allowed the buyer of a car with a previously perfected security interest to avoid liability. Although the security interest in *Kapral* was created by the buyer's seller and the buyer was thus protected by § 9-307(1), the court read the entrustment provision of § 2-403(2) as an additional source of protection for the buyer. *Id.* at 546.

In *Makransky v. Long Island Reo Truck Co.*, 58 Misc. 2d 338, 295 N.Y.S.2d 240, 5 U.C.C. Rep. Serv. (Callaghan) 1204 (1968), the Suffolk County (New York) Supreme Court held a secured party with a valid perfected security interest liable for conversion when it repossessed a truck from a remote buyer who bought without notice of the security interest. The court held that because a buyer in the ordinary course of business took free of an earlier security interest under § 9-307, and because the entrustment provision of § 2-403 entitled the intermediate seller to transfer rights to a buyer in the ordinary course, the secured creditor could no longer enforce his security interest.

117. In *Commercial Credit Corp. v. Associates Discount Corp.*, 246 Ark. 118, 436 S.W.2d 809, 6 U.C.C. Rep. Serv. (Callaghan) 82 (1969), the court held that the initial secured party's interest was severed by the entrustment of the vehicle to a merchant who subsequently sold the property in the ordinary course of business. The court held that the original lienholder's actions clearly qualified under the entrustment provisions of article 2 because it delivered the goods to the merchant's inventory for the purpose of his sale. The court dismissed without discussion the contention that the secured party's prior lien was still valid by the terms of § 9-307(1). *Id.* at 126, 436 S.W.2d at 813, 6 U.C.C. Rep. Serv. (Callaghan) at 87.

In *General Elec. Credit Corp. v. Western Crane & Rigging Co.*, 184 Neb. 212, 166 N.W.2d 409, 6 U.C.C. Rep. Serv. (Callaghan) 67 (1969), the court noted that the Code allows a buyer in the ordinary course of business to take free of a prior security interest in the property. In that case the original buyer had purchased a crane subject to General Electric's security interest. The buyer then turned the crane over to a dealer for repairs and, while on the dealer's lot, the crane was sold to a third party in the ordinary course of business. When the original buyer subsequently defaulted on the installment contract and the dealer became insolvent, General Electric sought to enforce the terms of the security interest against the buyer in the ordinary course of business. The court stated that if the Code were applicable, the buyer would prevail under § 2-403; however, because the transaction occurred prior to the effective date of the Code, the security interest would survive the sale in the ordinary course. *Id.* at 215, 166 N.W.2d at 411, 6 U.C.C. Rep. Serv. (Callaghan) at 69-70.

In ignoring the § 9-306(2) language limiting the source for exceptions to article 9, courts

is clearly appropriate. Section 9-306 itself deals only with the secured party's rights upon a disposition of the collateral by the debtor and is not intended to cover situations in which the secured party has control over the collateral and delivers it to a third party merchant himself.¹¹⁸ If, however, a finding of entrustment is based solely upon the secured party's acquiescence in the debtor's possession of the collateral, followed by the debtor's surrender of that collateral to a merchant, section 9-306(2) would appear to prohibit resort to article 2.¹¹⁹ Therefore, even if

have not only found relief in § 2-403, but have also resorted to common law principles. In *Muir v. Jefferson Credit Corp.*, 108 N.J. Super. 586, 262 A.2d 33, 7 U.C.C. Rep. Serv. (Callaghan) 273 (1970), the court applied the doctrine of equitable estoppel. See *supra* notes 88-89 & accompanying text.

The courts have found other ways to protect buyers as well. In addition to limiting protection to situations in which the security interest is created by the buyer's seller, § 9-307(1) excludes buyers of farm products from persons engaged in farming operations from protection altogether. In *United States v. Hext*, 444 F.2d 804, 9 U.C.C. Rep. Serv. (Callaghan) 321 (5th Cir. 1971), however, the court avoided both limitations. In *Hext*, the debtor was a farmer who granted a security interest to the Farmer's Home Administration (FHA) in cotton that he was to grow. The debtor was also the sole owner of a corporation in the cotton ginning business. After harvest the debtor transferred the cotton subject to the security interest to the corporation, which in turn sold the crop to third parties. The court concluded that the third parties were buyers in ordinary course and that their purchases effectively cut off the FHA's security interest. The court reasoned that the farm products exclusion did not apply since the buyers thought that they were purchasing from a ginning business rather than a farmer. *Id.* at 813, 9 U.C.C. Rep. Serv. (Callaghan) at 335-36. Furthermore, the court concluded that the created-by-his-seller limitation did not save the FHA's security interest because the FHA knew at the time the security interest was created that "the farmer who created the security interest was the sole owner of the Gin Co. which sold the cotton to the buyer." *Id.* at 814, 9 U.C.C. Rep. Serv. (Callaghan) at 336.

118. See U.C.C. § 9-306 comment 3 (1978). It is noteworthy that White & Summers appear to reach the opposite result: "[W]e conclude that the drafters intended that priority disputes between secured creditors and subsequent purchasers be governed exclusively by Article Nine and that they did not intend that such purchasers invoke the more generous provisions of 2-403." J. WHITE & R. SUMMERS, *supra* note 12, § 25-15, at 1074. The authors illustrate their conclusion with a hypothetical based on a decision handed down by the California Court of Appeals, *Security Pac. Nat'l Bank v. Goodman*, 24 Cal. App. 3d 131, 100 Cal. Rptr. 763, 10 U.C.C. Rep. Serv. (Callaghan) 529 (1972). In *Goodman*, the initial buyer owned a boat subject to a bank's security interest. The buyer returned the boat to the dealer without satisfying the bank's lien, and the merchant subsequently sold the boat to another buyer in the ordinary course of business. When the bank later attempted to repossess the boat from the second buyer, the court sustained its action on the theory that § 9-307(1) would not prevent the bank's repossession as the security interest had not been created by the immediate seller. Section 2-403 would aid the buyer only in a suit against the original owner for the excess of the boat's value over the value of the original owner's debt to the bank.

119. See *supra* text accompanying notes 113-15. The propriety of resorting to article 2 of the Code for resolution of the problem is left in doubt by the interarticle priority provisions of the Code. See Dugan, *supra* note 6, at 336-37. Section 9-201 allows an exception to the priority of a secured party by a provision of "this Act," which would clearly include the entrustment provisions of article 2. However, § 9-306(2) only limits the secured party's priority "where this Article otherwise provides," seemingly precluding any reference to article 2. In

one dismisses the prohibition as an oversight¹²⁰ on the part of the Code's drafters, and even if some courts are willing to weave a remedy for ultimate buyers in circumvention of the express direction of section 9-306(2), it is clear that section 2-403 provides no certain relief to buyers and that alternative approaches merit exploration.

Protecting Buyers of Goods by Finding Authorization in Entrustment

In one recent case, *In re Woods*,¹²¹ an interesting variation upon the themes of entrustment and authorization was introduced. James and Diane Brugh purchased a Toyota automobile from Tom Woods Used Cars in October 1980. The purchase was financed by First Tennessee Bank, which retained a security interest in the car and duly perfected its claim by noting the security interest on the certificate of title and by retaining possession of the title certificate.¹²² Approximately six months later, the Brughs returned the car to Tom Woods for resale with the intention that the car dealer would pay off the Brughs' auto loan from the proceeds of the sale.¹²³ Elizabeth Locke purchased the car from Tom Woods without knowledge of the bank's security interest.¹²⁴ Although Ms. Locke paid for the car, Tom Woods never remitted the proceeds of the sale to the bank.¹²⁵ When the dealer initiated insolvency proceedings shortly thereafter, the bank still held the title certificate. Ms. Locke sought at that point to have her rights in the car declared superior to those of the bank,¹²⁶ and the federal bankruptcy court granted the requested relief.¹²⁷

Conceding that the plaintiff could not avail herself of the protection of section 9-307(1) because the security interest casting a shadow on her

article 2, the interarticle priority provisions would seem to defer to article 9 when that chapter provides for specific rules. U.C.C. §§ 2-402(3), 2-403(4) (1978). This does not resolve the problem, however, when the provisions of article 9 do not specifically deal with an issue. Professor Dugan states that the coverage of the article 9 exceptions to the secured party's priority cannot be discerned by any precise formula, which would leave the choice between using article 2 or article 9 to considerations of policy. See Dugan, *supra* note 6, at 337.

120. J. WHITE & R. SUMMERS, *supra* note 21, § 25-15, at 1075.

121. 25 Bankr. 924, 35 U.C.C. Rep. Serv. (Callaghan) 256 (E.D. Tenn. 1982).

122. *Id.* at 925, 35 U.C.C. Rep. Serv. (Callaghan) at 258.

123. *Id.* at 926, 35 U.C.C. Rep. Serv. (Callaghan) at 258.

124. *Id.* at 927, 35 U.C.C. Rep. Serv. (Callaghan) at 260-61.

125. *Id.* at 928, 35 U.C.C. Rep. Serv. (Callaghan) at 261. Instead, Tom Woods deposited plaintiff's check in the dealership's account at another bank. Woods did not then remit a check to First Tennessee Bank because he knew that his bank would not honor it. *Id.* at 928, 35 U.C.C. Rep. Serv. (Callaghan) at 261-62.

126. *Id.* at 925, 35 U.C.C. Rep. Serv. (Callaghan) at 258. In the alternative, Ms. Locke sought to hold Tom Woods personally liable for the debt, which was not dischargeable in the insolvency proceeding. *Id.*

127. *Id.* at 932, 35 U.C.C. Rep. Serv. (Callaghan) at 268.

title to the automobile was not "created by [her] seller,"¹²⁸ the court applied the entrustment provisions of article 2. Despite some conflict in the testimony presented, the court found evidence to support the conclusion that the bank had received notice of the Brughs' surrender of the car to Tom Woods and, in fact, had entrusted the car to the dealer.¹²⁹ The court held that this acquiescence, coupled with the bank's failure to prevent the sale of the car to Ms. Locke, was an authorization of sale within the meaning of section 9-306(2). Therefore, the court held that even if the *Jones* court's conclusion is accurate¹³⁰ and the buyer's protection must be based exclusively upon an exception articulated in the provisions of article 9, evidence of entrustment may be used to bar a claim by the secured party on the ground that the subsequent disposition was authorized.¹³¹

The *Woods* decision clearly represents a new judicial maneuver to find implicit Code protection for the innocent buyer of goods subject to a previously executed security interest, although the Code has failed to provide such protection expressly. However, the reasoning in *Woods*, though motivated by concerns for the unprotected buyer and thus justifiable in many cases as a matter of equity and conscience, often will afford an inadequate or an inappropriate remedy. The *Woods* analysis will not apply to situations in which entrustment and consequent authorization cannot be found on the facts. Thus, the secured party's acquiescence and authorization of the debtor's transfer of the collateral will not be implied absent notice of such transfer to the secured party. Furthermore, the entrustment necessary to find creditor consent should not be found in every transfer of possession with notice. For example, if goods are delivered to a dealer solely for purposes of repair, a finding of an entrustment sufficient for the application of section 9-306(2) would be manifestly unjust to the secured creditor. In this situation, the *Woods* approach might allow a purchaser from the merchant to obtain clear title. The secured

128. *Id.* at 929, 35 U.C.C. Rep. Serv. (Callaghan) at 263.

129. *Id.* at 930-31, 35 U.C.C. Rep. Serv. (Callaghan) at 264-67. The evidence relied on by the court to find entrustment was marked by sharp conflicts in testimony concerning the bank's alleged acquiescence in the Brughs' sale of the property. The bank presented its records as evidence to indicate that there had been no mention of the sale of the car, and therefore that the bank lacked notice of the disposition of the collateral. The court noted, however, that the head of the bank's financing department, Dexter Smith, conducted an inventory check of Woods' lot the day after the car was returned by the Brughs. The court further observed that this inventory check surely would have revealed the return of the car and, if not, that Woods certainly would have pointed that fact out to Dexter Smith. Either of these two occurrences was held sufficient to put the bank on notice of the disposition of the collateral, allowing the court to find entrustment of the property according to the terms of article 2. *Id.* at 931, 35 U.C.C. Rep. Serv. (Callaghan) at 266-67.

130. See *supra* notes 113-15 & accompanying text.

131. *Woods*, 25 Bankr. at 929-30, 35 U.C.C. Rep. Serv. (Callaghan) at 264.

party, however, should not be held to possess sufficient knowledge of the facts to have authorized the subsequent sale or to be estopped from asserting his claim by virtue of a failure to act.

The legitimate interests of a secured creditor may be jeopardized by judicial decisions that too readily infer authorization to dispose of the collateral from inconclusive facts. At a minimum, permission to sell or to exchange collateral subject to a security interest should be found only upon a showing that (1) the secured creditor had actual knowledge of circumstances that would inform a reasonable person that disposition was imminent and (2) an objection should have been raised to prevent it.

Balancing The Equities

In weighing the relative equities in favor of a buyer and a secured party with conflicting claims to collateral, recourse may be had to analogous situations in which the law requires a balancing of interests in property against the interests of purchasers in the market. Strong social policy interests are served by protecting ownership rights¹³² and encouraging unfettered operation of the market system.¹³³ In accommodating these inevitably conflicting objectives, certain principles have been developed and generally applied. First, what has been called the "shelter" principle provides that a transfer of property endows the transferee with all rights the transferor had or had power to convey.¹³⁴ Pursuant to this principle, the transferee will usually be held subject to any claims or defenses that would have been effective against his transferor. It is as if the transferee stood in the shoes of his transferor for purposes of asserting or resisting claims with respect to the subject matter of the transaction. Second, a corollary to the first, is the principle that one with void title has no power to convey any title.¹³⁵ Inherent in this principle is the idea that perfidy should not be protected and that one who has been unlawfully deprived of his property should have the power to recover it, no matter in whose hands it has surfaced. Third, as a general principle of law, some fault or negligence of the owner that results in loss may be sufficient to deprive the owner of the right to recover the property in the hands of a good faith purchaser for value. This proposition is variously stated as the ability of one with voidable title to transfer good title to a good faith purchaser for value, or when one of two innocent parties must

132. See Dolan, *supra* note 60, at 820.

133. See Skilton, *supra* note 6, at 3-4.

134. Dolan, *supra* note 60, at 812.

135. See *supra* note 97.

bear the loss, it will be allocated to that party in the best position to avoid it or whose conduct caused the loss to occur.

In the battle between the secured party and the remote good faith purchaser, the first two principles are inapposite. The shelter principle generally will not protect the buyer¹³⁶ because the buyer traces his title from the original seller/debtor. Because he acquires no greater rights than his transferor had to convey, the buyer remains subject to the previously created security interest. The principle that one with void title has no power to convey any interest generally will not apply because the debtor generally does not gain possession of the goods unlawfully. Therefore, his title is not void.

The principle that fault or negligence can deprive an owner of the right to retrieve the property from an innocent party seems most appropriate to resolution of the problem of the buyer of used goods. If a buyer acquires voidable title by virtue, for example, of duping the seller into parting with the goods, section 2-403(1) provides that the seller's interest may be terminated by a further conveyance to a good faith purchaser. In this situation, it may be said that the original seller in some sense contributed to his own loss by imprudently but voluntarily surrendering possession to a party who turned out to be untrustworthy. Although such imprudence may not rise to the level of blameworthiness, it is nonetheless appropriate that the imprudent party bear the loss. As between the two innocent parties, he was in the best position to have averted catastrophe.

These general principles are reflected throughout the Code, in article 2 (Sales),¹³⁷ article 3 (Commercial Paper),¹³⁸ article 7 (Documents of Title),¹³⁹ and even in article 9.¹⁴⁰ In the context of the general acceptance of these principles, particularly the third principle, the rule of section 9-306(2)—that a security interest continues in collateral forever, “notwithstanding sale, exchange or other disposition”¹⁴¹ and, presumably, notwithstanding the circumstances under which the disposition occurred or the good faith of the buyer and value given—is anomalous,

136. *But see supra* note 120.

137. *E.g.*, U.C.C. § 2-403 (1978).

138. *E.g., id.* § 3-201(1) (transfer of an instrument vests in the transferee such rights as the transferor had therein); *id.* § 3-305 (a holder in due course, with limited exceptions, takes an instrument free from claims).

139. *E.g., id.* § 7-502 (a holder of a negotiable instrument which has been duly negotiated acquires certain rights); *id.* § 7-503(1) (documents of title to goods may be defeated by a secured party in certain instances).

140. *E.g., id.* § 9-302(2) (no filing required to continue perfected status of an assigned security interest); *id.* § 9-318 (rights of assignee are subject to the defenses or claims of account debtors).

141. *Id.* § 9-306(2).

unless the exception for "authorized" dispositions is interpreted broadly to encompass negligent supervision or imprudent action by the secured creditor. No apparent reason in policy or history justifies a refusal to permit reference to article 2 provisions, or analogous principles at common law, to protect the ordinary course buyer.

Perhaps the Code does permit such reference by virtue of its assertion that general principles of law and equity may supplement Code provisions unless they have been displaced in the Code itself.¹⁴² The question then is whether the language of section 9-306(2), "[e]xcept as otherwise provided in this Article," operates to displace the general property rules discussed above. Although the answer would seem to be affirmative, courts seem unwilling to enforce the harsh results dictated by this conclusion.¹⁴³ It is unlikely that the Code's drafters intended a unique exclusion of general property rules universally incorporated in other articles. One may persuasively argue that these rules should not be displaced and that any provision to the contrary is a product of inadvertence.

A satisfactory resolution of the conflict between secured creditors and remote buyers is one that will accommodate the legitimate interests of each and that is in harmony with the underlying policies and principles of property law outlined above. Because the case posing the dilemma of the second buyer is most clearly analogous to the situations described in section 2-403(1), dealing with voidable title, a rule that takes account of negligent or imprudent conduct on the part of the secured party and that endeavors to secure the reasonable expectations of both parties would seem to yield the fairest result. In seeking this accommodation of interests, the *Woods* rationale must be rejected as too narrow to offer adequate protection to either buyer or creditor. Indeed, a more clear and equitable accommodation of these competing claims appears to require amendment of the Code; however, such amendment need not impair the apparent intent of the drafters nor violate the spirit of the Code when its provisions are taken as a whole.

Proposal

Many commentators who have considered the remote buyer's dilemma have suggested a simple amendment to the Code to eliminate the restrictive "created by his seller" language in section 9-307(1).¹⁴⁴ Such

142. *Id.* § 1-103.

143. *See supra* note 60.

144. *See, e.g.,* Knapp, *supra* note 7, at 892; Vernon, *supra* note 7, at 536.

an amendment would allow any buyer in ordinary course to acquire goods free from the claims of prior secured creditors. While this proposal produces a desirable result for the beleaguered buyer, it takes inadequate account of the legitimate interests of the secured creditor who has followed all the rules by filing a perfecting statement and has refrained from authorizing disposition of the collateral, but has been unable to avert his debtor's perfidious action. To declare an immediate end to his security interest at the moment of an ordinary course purchase is effectively to deny him any remedy in the circumstances, a result no more tolerable for secured parties than the perpetual security interest afforded by section 9-306(2) has proven to be for remote buyers.

A Proposed Four-Month Rule

In several sections of article 9, a four-month rule is adopted for purposes of delineating the point after which a secured creditor is no longer guaranteed an effective security interest, if circumstances have changed.¹⁴⁵ Under section 9-402(7), for example, if a change in the debtor's name renders a previously filed financing statement seriously misleading, the filing is effective to perfect a security interest in collateral acquired by the debtor for only four months after the debtor's name change. The secured party must file a new financing statement within that four-month period to keep his interest perfected.¹⁴⁶

The notion of a creditor's need to be aware of changed circumstances and to act promptly to maintain perfected, secured status is an integral facet of the section dealing with multistate transactions. If goods subject to a perfected security interest in one state are removed to another, the Code provides that the perfection of the security interest will continue to be determined by the law of the original jurisdiction for a period of four months,¹⁴⁷ or less, if the original financing statement expires earlier.¹⁴⁸ In order for the security interest to remain perfected beyond that period, the secured party normally must act within four months to perfect the security interest in the jurisdiction to which the

145. U.C.C. §§ 9-103(1), 9-401(3) (alternative), 9-402(7) (1978).

146. *Id.* § 9-402(7).

147. *Id.* § 9-103(1)(d). The four-month period begins to run from the time the collateral enters the destination state. This provision applies to documents and instruments that are used as collateral, as well as to goods. *Id.* § 9-103(1)(a).

148. The specified "grace period" in which to reperfect is stated to be four months after the collateral is brought into the new state or the period of perfection in the original jurisdiction, whichever expires first. *Id.* § 9-103(1)(d). A filed financing statement remains effective for five years from the date of filing. *Id.* § 9-403(1).

collateral has been removed.¹⁴⁹ A failure to reperfect in the second jurisdiction will cause the security interest to lapse, and it will thereafter be deemed unperfected as against purchasers of the collateral whose interests arise after removal.¹⁵⁰ A related provision limits the effectiveness of a financing statement, and therefore perfection, to four months after a change in circumstances controlling the place of filing within one particular jurisdiction.¹⁵¹

The operation of section 9-103 thus deprives the secured party of perfection (and hence priority) at the end of a four-month period unless the secured party takes some action to continue that perfection. This provision reflects the view that a secured party bears a burden of policing the collateral in the debtor's possession, at least to the extent of ascertaining periodically whether the debtor has removed the collateral from the jurisdiction. The rule applies regardless of the secured party's knowledge of the removal and regardless of when the secured party acquired such knowledge. In a typical case of removal of the collateral to another jurisdiction, constructive notice of this event, indicating the need for investigation, may reach a secured creditor by virtue of a change of return address of the debtor at the time monthly payments are submitted, or even by virtue of a debtor's failure to make scheduled payments. Either event should be sufficient to alert the creditor of the need to investigate further the whereabouts of the collateral. The Code, however, does not explicitly require notice to the secured party of the occurrence of the event (removal of the collateral from the jurisdiction) that jeopardizes the status of his security interest. Notwithstanding the existence or absence of clues, the secured party must reperfect in the destination state within four months after the goods have come to rest in that jurisdiction, or risk loss to a subsequent purchaser of the collateral. In this sense, the Code allocates the risk attending a failure to act—and the corresponding obligation to keep an eye on the location of the collateral—entirely to the secured creditor.

The adoption of a four-month grace period represents a recognition

149. Section 9-103(1) requires action to reperfect in the destination state within the four-month period "if action is required by Part 3 of this Article to perfect the security interest." *Id.* § 9-103(1)(d) (emphasis added). In cases in which perfection is automatic, no action will be required. A common example of automatic perfection is found in the case of a purchase money security interest in consumer goods which are neither fixtures nor motor vehicles required to be registered. *Id.* § 9-302(1)(d).

150. *Id.* § 9-103(1)(d).

151. *Id.* § 9-401(3) (alternative). This provision addresses a change in the county of the debtor's place of business or residence, or the county in which the collateral is located, which ever controlled the original filing. The alternative § 9-401(3) has been adopted in six jurisdictions (Delaware, Pennsylvania, Texas, Virgin Islands, West Virginia, and Wyoming).

by the Code drafters that the interests of the secured party and the claims of other innocent creditors and purchasers¹⁵² of the collateral are both worthy of consideration¹⁵³ and that accommodation among these competing interests is appropriate. As explained by one commentator:

A fair compromise in the conflict between the two innocent parties is attempted by giving the secured party four month's time to discover the removal and to refile in the new jurisdiction, and by giving the bona fide purchaser a reasonable chance to win this game by getting across the period without refileing the security interest.¹⁵⁴

The four-month rule thus operates as a true compromise of legitimate and competing claims.

The rule reflects a determination that, in most cases, a four-month period is adequate for the secured party to discover a change in circumstances and to take proper action to ensure continued perfection.¹⁵⁵ By providing a cut-off point for such action, the rule also allows a subsequent purchaser a certain modicum of safety: if she can ascertain that the collateral has been in her jurisdiction for four months without a filing, she is assured of priority over the claim of a previously perfected out-of-state secured creditor.¹⁵⁶

152. A "purchaser" includes a secured party. U.C.C. §§ 1-201(32), (33) (1978). The term also includes a nonordinary course buyer, *United States v. Squires*, 378 F. Supp. 798, 15 U.C.C. Rep. Serv. (Callaghan) 718 (S.D. Iowa 1974); however, the term "purchaser" does not include a lien creditor or bankruptcy trustee under § 70(c) of the Bankruptcy Act of 1898, 11 U.S.C. §§ 541(e), 544(a) (1982). See generally J. WHITE & R. SUMMERS, *supra* note 12, § 23-18, at 976.

153. [The four-month] rule differs from the former rule of Section 14 of the Uniform Conditional Sales Act. Under that section a conditional seller was required to file within 10 days after he "received notice" that the goods had been removed into this state. Apparently, under the Uniform Conditional Sales Act, if the seller never "received notice" his interest continued or became perfected in this state without filing. Paragraph (1)(d) proceeds on the theory that not only the secured party whose collateral has been removed but also creditors of and purchasers from the debtor "in this state" should be considered.

U.C.C. § 9-103 comment 7 (1978). Clearly, the four-month rule reflects an attempt by the drafters to strike a balance between the interests of out-of-state creditors and the interests of innocent in-state purchasers.

154. Schuschke, *Conflict of Laws and the Security Interest: The Four-Month Rule of UCC Section 9-103(1)*, 85 COM. L.J. 525, 528 (1980) (footnote omitted).

155. The four month period is long enough for a secured party to discover in most cases that the collateral has been removed and refile in this state; thereafter, if he has not done so, his interest, although originally perfected in the jurisdiction from which the collateral was removed, is subject to defeat here by purchasers of the collateral. U.C.C. § 9-103 comment 7 (1978).

156. "An innocent purchaser wishing to buy the collateral or a creditor contemplating an extension of credit will be safe if he can assure himself that the collateral has been in state for at least four months without a filing." J. WHITE & R. SUMMERS, *supra* note 12, § 23-18, at 976.

A similar rule would be useful in reconciling the conflict between remote secured parties and purchasers of the collateral from an intervening dealer to whom the debtor has effected a transfer. The four-month limit on the effectiveness of the security interest following unauthorized disposition of the collateral should apply only in cases in which the collateral has been sold to a buyer in ordinary course of business. This proposal could be implemented by amending section 9-307(1) to read:

A buyer in ordinary course of business (subsection (9) of Section 1-201) other than a person buying farm products from a person engaged in farming operations takes free of *any* security interest (even though perfected and even though the buyer knows of its existence) if such security interest is

(a) created by his seller, or

(b) *created by a predecessor in interest of his seller, unless the secured party declares a default and proceeds under Part 5 of this Article within four months after an unauthorized disposition of the collateral by the debtor.*¹⁵⁷

Alternatively, section 9-306(2) could be amended to provide:

Except where this Article otherwise provides, a security interest [continues] in collateral *remains effective* notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor. *If the collateral is in the possession of a buyer in ordinary course of business (subsection (9) of Section 1-201), the security interest in the collateral becomes ineffective after four months from the date of the debtor's unauthorized disposition of the collateral.*¹⁵⁸

Under either form of this proposal, the secured party with a perfected security interest in collateral would retain priority over a subsequent purchaser for four months after the debtor has relinquished possession of the collateral without authority. The security interest would continue to be effective following the expiration of that four-month period unless the collateral is in the possession of a buyer in ordi-

157. The current version of § 9-307(1) would be amended by addition of the italicized language.

It should be noted that this form of the proposal is based on the assumption either that a disposition of the collateral by the debtor constitutes a default under the terms of the security agreement, or that the disposition is accompanied by a failure to make payments on the obligation, which would itself constitute a default. See *supra* note 37. In Massachusetts, § 9-307(1) has been amended to add the following subsection: "and (b) takes free of a security interest created by a predecessor in interest of his seller if the buyer buys without knowledge of the security interest and for his own personal, family or household purposes." MASS. GEN. LAWS ANN. ch. 106, § 9-307(1)(b) (West 1974). Under this provision, only consumer buyers in ordinary course are protected, and the secured party has no opportunity to avert loss caused by unauthorized disposition in situations in which the rule applies.

158. Recommended deletions are placed in brackets ([]); proposed additions are italicized.

nary course. As is the case wherever such a grace period is provided, this proposal would impose upon the secured party an obligation to police the collateral, at least to the extent of ascertaining its continued location in the hands of the debtor, and to take further action to assert his interest against collateral in possession of a dealer or merchant.¹⁵⁹ The secured party's failure to determine the occurrence of an unauthorized disposition and to act promptly to repossess the collateral would have the same legal consequences as acquiescence or authorization vis-a-vis a claim asserted by a buyer in ordinary course. By the same token, a later purchaser who ascertained that the goods had remained for four months in the hands of one against whom no filing had been made would be assured of clear title at the time of purchase, free from the prior encumbrance.¹⁶⁰

This proposal would require a secured party to take action to repossess collateral in which he claims a security interest within four months after the debtor has transferred possession without authority. A failure to take such action effectively would terminate the secured party's interest in the collateral itself vis-a-vis a buyer in ordinary course of business, but would leave the secured party free to realize his claim out of identifiable proceeds pursuant to other Code provisions.¹⁶¹ The consequences of this proposal are analogous to the effects of section 9-103; the security interest in each case continues in the collateral unless and until there is a mishap. Once the interests of an innocent third party have intervened, and following the expiration of the prescribed grace period, the secured party's claim would be subordinate to the claims of the subsequent purchaser, and the secured party would be otherwise relegated to its claim to proceeds. In both cases, the risk incurred is merely a risk of a potential loss, dependent upon the appearance of a requisite third party whose claim should be accorded priority, avoidable by timely policing or supervision of the collateral in the hands of the debtor, and incurred only under circumstances in which the relative equities are deemed to weigh in favor of a bona fide purchaser.

159. Because the proposal incorporates the Code's preference for the buyer if the security interest is created by the buyer's seller, it might seem that the merchant who buys the goods from the debtor can preclude action by the secured party simply by holding the goods for four months. However, the merchant rarely will be entitled to protection as a buyer in ordinary course, because the debtor generally will not be a person engaged in the business of selling goods of that kind. See *supra* notes 29-30 & accompanying text.

160. Compare *supra* note 156. Obviously, if the later purchaser buys from the debtor, the existence of the previously perfected security interest will be ascertainable from the filing records. If the purchaser further qualifies as a buyer in ordinary course of business, the existing version of § 9-307(1) allows him to take free of the security interest in this case.

161. A right to proceeds is clearly preserved under §§ 9-203(3) and 9-306(2). The procedure for maintaining perfection of a security interest in proceeds is articulated in § 9-306(3).

The risk allocated to the secured party under this proposal is not unduly oppressive. The secured party's security interest is not lost at the end of four months, but merely subordinated to the claim of the later buyer. Even this subordination would occur only if the buyer qualified as a buyer in ordinary course of business. In any case, the secured party would retain his claim to any proceeds in the debtor's hands under the terms of the security agreement. Moreover, a claim by the secured party against either the collateral or the proceeds of the collateral in the hands of a nonbuyer in ordinary course, including in certain instances an intervening dealer, would remain.

In requiring action against the collateral rather than the mere filing of a financing statement within four months, the proposal departs from the analogy of section 9-103.¹⁶² The justification for this departure and the imposition of a more onerous obligation on the secured party may be found in an examination of the relative equities of the secured party and the ultimate purchaser.¹⁶³ These equities are not the same in cases of removal of the collateral and unauthorized conveyance. For example, a purchaser of collateral subject to a security interest perfected in another

162. In the alternative, a proposal which more closely parallels § 9-103 could be considered. A secured party's perfected security interest could continue in collateral for four months after unauthorized disposition by the debtor and thereafter if a financing statement were filed which named the new holder of the collateral. A failure to refile within the four-month period would result in subordination of the secured party's claim to the interests of intervening purchasers. Cf. U.C.C. § 9-103(1)(d)(i) (1978). Implementation of this alternative proposal properly would involve amending § 9-402(2) to include unauthorized disposition as a circumstance permitting a financing statement to be filed with the signature of the secured party alone.

In permitting a secured party to protect his interest by filing a financing statement, and in enforcing security interests covered by a filing against consumer buyers who have no knowledge of the previous encumbrance, this alternative proposal is consistent with other Code priority provisions, most notably § 9-307(2) (the consumer-to-consumer sale provision). See generally *supra* notes 33-35 & accompanying text. The merit of such an amendment would lie in ensuring that a buyer of used goods is at least in a position to ascertain the existence of the security interest, even if he would not ordinarily avail himself of that opportunity. See *infra* note 162. The thesis of this Article, however, to the effect that the interests of both parties are more effectively accommodated by terminating the security interest at some point, leads the author to refrain from advancing this alternative with any enthusiasm.

163. The proposal also arguably places an additional burden on the second buyer in situations in which the debtor continues to make payments on the obligation. In such a case, the secured party has no choice but to proceed immediately against the collateral rather than await a default in payment. If the secured party fails to foreclose within four months, his security will be lost forever. Although the secured party will thus be compelled to deprive the second buyer of possession within the four month period despite continued payment on the original debt, such a result is reasonable. First, it seems likely that it will be a rare case indeed when the debtor disposes of the collateral but continues to make payments. Second, since the secured party must act promptly, the second buyer has a better chance of successfully recovering from either her seller or the debtor. Finally, the burden imposed is negligible when compared to the advantage of complete security after the four month period has run.

jurisdiction presumably has the ability to investigate the seller and, if necessary, to consult the records of financing statements in the seller-debtor's jurisdiction of origin.¹⁶⁴ As previously noted, however, an ordinary course buyer of used goods subject to a previously created security interest normally will be unaware of the debtor's identity and consequently is in the dark about how to protect herself. Given the reasonable expectations of the buyer¹⁶⁵ and the respective abilities of the secured creditor and the ultimate purchaser to avoid the loss, it seems appropriate to require the secured party to assert his claim expeditiously or be deprived of seeking satisfaction out of the hide of the buyer. The latter, we presume, has acted innocently, in good faith, and in reliance on obtaining good title and has now been lulled into a false sense of security by the opportunity to enjoy uninterrupted use of the collateral for a period of several months.

Conclusion

The Uniform Commercial Code makes no provision for the protection of a buyer in ordinary course who purchases used goods from a

164. To have this ability, however, does not ensure the inclination. As a practical matter, an ordinary course buyer does not demand the seller's completion of a biographical questionnaire before buying. In all likelihood, therefore, the existence of an effective out-of-state security interest will not be discovered in most cases. In an ideal Code world the buyer might well ask: "How long have these goods been in this state?;" "Are the goods subject to an extraterritorial security interest?;" "Where did you live before?;" and "Will you kindly suspend this transaction long enough for me to consult the filing records of the appropriate clerk in your previous jurisdiction-of-residence?" Consumer education doubtless aspires to this level of business acuity; were it achieved, all commerce might well grind to a screeching halt.

At this point, however, it is significant to note that the Code is frequently unconcerned with the practical consideration that buyers will not usually take all precautions available to avoid loss. Under § 9-307(2), for example, a consumer who buys from a consumer is subordinate to a perfected secured claim if the secured party has filed a financing statement. Since a consumer buyer of consumer goods at a garage sale is most unlikely to think to check the filing records, the outcome under § 9-307(2) would seem more dependent upon fortuity than reason. What is important here, though, is that the consumer buyer in this situation *could* act to protect himself. The wherewithal to avoid loss is at least within his reach. *Compare supra* text accompanying note 57.

165. For the proposition that buyers are entitled to fulfillment of their consumer expectations and that avoidance of consumer disappointment is a policy objective in the product liability context, see generally RESTATEMENT (SECOND) OF TORTS § 402A comments (g), (i) (1965); *Greenman v. Yuba Power Prods., Inc.*, 59 Cal.2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963); *Leichtamer v. American Motor Corp.*, 67 Ohio St. 2d 456, 424 N.E.2d 568 (1981); Britain, *Product Honesty is the Best Policy: A Comparison of Doctors' and Manufacturers' Duty to Disclose Drug Risks and the Importance of Consumer Expectations in Determining Product Defect*, 79 NW. U.L. REV. 401 (1984); Green, *Strict Liability Under Sections 402A and 402B: A Decade of Litigation*, 54 TEX. L. REV. 1185 (1976); Shapo, *A Representational Theory of Consumer Protection: Doctrine, Function and Legal Liability for Product Disappointment*, 60 VA. L. REV. 1109 (1974).

dealer. Because a pre-existing security interest will usually continue in those goods after disposition¹⁶⁶ and will not have been "created by [the buyer's] seller,"¹⁶⁷ the remote buyer's claim to good title is subordinate to the claim of the secured creditor.¹⁶⁸ In their efforts to achieve a fair result for the innocent purchaser, courts have engaged in strained or erroneous interpretations of the Code, which impede the development of a coherent theory of commercial law. What is needed is a rule of law that works for everyone, a rule that will reward diligent action, satisfy reasonable commercial expectations, and accommodate the legitimate yet competing interests of the ordinary course purchaser and the secured party. Amendment of the Code to provide a four-month rule to limit the long arm of the previously created security interest represents a fair compromise of these competing claims.

166. U.C.C. § 9-306(2) (1978).

167. *Id.* § 9-307(1).

168. *See supra* notes 26-46 & accompanying text.